103

UNITED STATES-JAPAN TRADE, COMMERCIAL, AND ECONOMIC RELATIONS

Y 4. W 36: 103-35

United States-Japan Trade, Commerci...

HEARING

BEFORE THE

SUBCOMMITTEE ON TRADE

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

JULY 13, 1993

Serial 103–35

Printed for the use of the Committee on Ways and Means

JAN 11 1994

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UNITED STATES-JAPAN TRADE, COMMERCIAL, AND ECONOMIC RELATIONS

TUESDAY, JULY 13, 1993

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON TRADE,
Washington, D.C.

The subcommittee met, pursuant to call, at 10 a.m., in room 1100, Longworth House Office Building, Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

[The press release announcing the hearing follows:]

FOR IMMEDIATE RELEASE
WEDNESDAY, JUNE 30, 1993

SUBCOMMITTEE ON TRADE #12
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1102 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-1721

THE HONORABLE SAM M. GIBBONS (D., FLA.), CHAIRMAN,
SUBCOMMITTEE ON TRADE, COMMITTEE ON WAYS AND MEANS,
U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES A PUBLIC HEARING
ON UNITED STATES-JAPAN TRADE, COMMERCIAL, AND ECONOMIC RELATIONS

The Honorable Sam M. Gibbons (D., Fla.), Chairman of the Subcommittee on Trade, Committee on Ways and Means, U.S. House of Representatives, today announced that the Subcommittee will hold a public hearing on U.S.-Japan trade, commercial, and economic relations. The hearing will be held on Tuesday, July 13, 1993, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.

Japan is one of the United States' most important trading partners. Japan is the second largest (Canada is the first) export market for U.S. goods and also the second largest source of U.S. imports (again behind Canada). In the post Cold War era, trade, commercial, and economic issues are likely to take on new significance in the overall U.S.-Japan relationship, which in the past has been influenced more by foreign policy and national security concerns.

The U.S.-Japan trade relationship has been as problematic as it has been important. U.S.-Japan trade frictions stem from a number of factors, the most obvious of which is the large merchandise trade surplus Japan has run with the United States and with the rest of the world (ROW). In 1992, Japan's surplus with the United States was approximately $48 billion and with the ROW, a record of $133 billion. A second source of difficulty has been Japan's failure to eliminate key barriers to market access. Such barriers include structural impediments, such as Japan's closed distribution system and Japanese land policy, and sectoral barriers in industries, including autos and auto parts, supercomputers, satellites, forestry products, agricultural products, telecommunications equipment, and construction. A third set of problems has arisen in conjunction with certain Japanese imports into the United States, particularly in key industries such as autos and steel. Finally, the U.S.-Japan trade relationship has been strained by allegations that Japanese-owned companies producing in the United States, the so-called "transplants," have engaged in anticompetitive practices.

Although the Clinton Administration's policy on trade is evolving, recent reports indicate that the President and his trade and economic officials intend to take a pragmatic, "results-oriented" approach to tackling problems in the U.S.-Japan economic relationship. Among the objectives of this approach are to enhance American goods' and services' access to the Japanese market and to encourage Japanese "transplants" to source more from American companies.

On April 16 of this year, President Clinton and Prime Minister Miyazawa met in Washington, at which time the two leaders agreed to forge a new, multifaceted framework for negotiations over the next three years on bilateral trade, commercial, and economic issues. U.S. and Japanese negotiators have since had a series of talks on this framework, with the intent of reaching agreement by as early as the July 7-9 summit of the Group of Seven (G-7) countries in Tokyo.

According to press reports, the United States has proposed a framework that includes macroeconomic objectives such as a reduction in Japan's merchandise trade surplus as a percentage of gross domestic product (GDP) and an increase in the value of foreign manufactured imports into Japan, also as a percentage of GDP. In addition, the United States has suggested that negotiations with Japan focus on baskets of sectoral and structural problems, including (1) Japan's compliance with existing trade agreements; (2) Japanese government procurement; (3) regulatory reform and regulated industries in Japan; (4) Japan's automobile and automotive parts industry in Japan and in the United States; and (5) U.S.-Japan "economic integration," which encompasses investment practices, technology transfer, intellectual property rights, emerging technologies, and long-term business relationships.

With the Clinton Administration's policy on Japan taking shape, and with the potential for further developments in the bilateral framework negotiations at the upcoming G-7 summit in Tokyo, it is an opportune time for the Subcommittee to hear testimony from Administration officials and from interested public witnesses on U.S.-Japan trade, commercial, and economic relations. This hearing will provide the Administration with a forum in which to brief the Subcommittee on the results of the G-7 summit in Tokyo, both generally, and specifically, with respect to U.S.-Japan relations. In addition, the Subcommittee is interested in hearing testimony from others who wish to provide their views on the U.S.-Japan trade relationship and how the Administration is dealing with it.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD:

Requests to be heard must be made by telephone to Harriett Lawler, Diane Kirkland, or Karen Ponzurick [telephone (202) 225-1721] by close of business Wednesday, July 7, 1993. The telephone request should be followed by a formal written request to Janice Mays, Chief Counsel and Staff Director, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. The Subcommittee staff will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Subcommittee office [(202) 225-3943].

In view of the limited time available to hear witnesses, the Subcommittee may not be able to accommodate all requests to be heard. Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearing. All persons requesting to be heard, whether they are scheduled for oral testimony or not, will be notified as soon as possible after the filing deadline.

Witnesses scheduled to present oral testimony are requested to briefly summarize their written statements. The full statement will be included in the printed record.

In order to assure the most productive use of the limited amount of time available to question hearing witnesses, witnesses scheduled to appear before the Subcommittee are required to submit 150 copies of their prepared statement to the Subcommittee on Trade office, room 1136 Longworth House Office Building, at least 24 hours in advance of their scheduled appearance. Failure to do so may result in the witness being denied the opportunity to testify in person.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:

Any interested person or organization may file written comments for inclusion in the printed record of the hearing. Persons submitting written comments for the printed record should submit at least six (6) copies of their comments by the close of business Monday, July 19, 1993, to Janice Mays, Chief Counsel and Staff Director, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements for the printed record of the hearing wish to have their statements distributed to the press and the interested public, they may provide 100 additional copies for this purpose to the Subcommittee office, room 1136 Longworth House Office Building, before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

* * * * * * * * * *

Chairman GIBBONS. Good morning.

Is Mr. Dreier present?

[No response.]

Chairman GIBBONS. Ambassador Kantor, let's take you first.

While Ambassador Kantor is taking his place, let me make an opening statement, then any other members who want to can make a statement.

Mr. Ambassador, we called this meeting this morning because we wanted a firsthand report from you on the two things you have been participating in in Tokyo: one, the jump starting of the Uruguay round; and two, the meeting of the G–7 countries. We would like your views and we ask you to be as candid as you can be in this public arena. We are particularly interested in the bilateral framework agreement that you concluded with Japan in an effort to begin opening the Japanese market. We realize that the Japanese Government is in a shaky position in that it is facing elections very shortly, and that Tokyo is not really in a position to do much bargaining. Nevertheless, we are going to have to follow the negotiations very closely. And as I told the two deputies seated on either side of you the other day, we really want to find some objective criteria by which we can grade and judge the effectiveness of U.S. policy vis-a-vis Japan, and we are going to have to follow the negotiations very closely. We realize the framework agreement is just a part of the development of these criteria.

So, Mr. Payne or Mr. Crane, would you like to make statements before we hear from Ambassador Kantor?

All right, fine. Ambassador Kantor, let's go ahead.

Mr. CRANE. Wait, I would like to say something.

Chairman GIBBONS. Oh, Mr. Crane has something he wants to say.

Mr. CRANE. I would like to make a brief statement. Thank you, Mr. Chairman.

Mr. Chairman, I want to welcome Ambassador Kantor here to discuss the recent step forward in the Uruguay round talks. Though modest in substance, the G–7 market access agreement is important symbolically. However, much remains to be done in the tariff area and the United States should not continue to be recalcitrant in agreeing to moderate some of our very high tariff peaks, especially in the textile area if we expect success.

The U.S. bilateral trade deficit with Japan and Japan's extraordinary trade surplus with the world are difficult problems that must be addressed, but success in this area will not come through intervention by zealous governments, but rather through reliance on market forces. The enormous trade flows between our two countries represent millions of individual economic transactions that are a testimony to competitiveness.

In the upcoming framework talks with Japan, I urge you to focus on actual government restrictions to market access in Japan. We should seek to deregulate the Japanese economy so our entrepreneurs will have more opportunities to succeed there. Most importantly, we must urge Japan to assume responsibility for the world trading system commensurate with the large economic benefits it receives from liberalized trade. There are important issues in the round where Japan needs to give more and work harder to

help develop consensus on tariffs, market access, and services in particular. We must assess our problems with Japan in light of the many positive aspects of the bilateral relationship.

Japan is our second most important export market, and Japanese citizens spend more per capita to purchase U.S. goods than U.S. citizens spend to purchase Japanese products. U.S. exports to Japan increased 109 percent between 1986 and 1992, and last year U.S. exporters sold $47.8 billion of exports to Japan, making it a very lucrative market, indeed. In short, the bilateral imbalance is only a small part of a much larger, more complicated, and I think more positive picture.

I thank you for yielding, Mr. Chairman, and I look forward to today's testimony.

Chairman GIBBONS. Well, thank you.

Let me make an administrative announcement before we start. We have to clear this room today by 12:45 in order to make room for a meeting with Ambassador Kantor and his colleagues who are to brief us on this same subject, so I wish all witnesses would keep that in mind and try to keep their remarks as succinct as possible.

Ambassador Kantor.

STATEMENT OF HON. MICHAEL KANTOR, U.S. TRADE REPRESENTATIVE

Ambassador KANTOR. Thank you very much, Mr. Chairman. I am glad to have not only you, but Congressman Crane and Congressman Payne, and I will let them debate some of the finer points of this among themselves as we go forward with the Uruguay round. Obviously, as you reach these agreements, there are always areas in which people will disagree, Mr. Chairman, as to how you should negotiate and what should be obtained, but let me just say that we view what the President accomplished at the G–7 in terms of the Uruguay round as a breakthrough. For 7 years we have been seeking a market access agreement in manufactured products, and that was achieved. There were some people who will believe we didn't get enough, some people who will believe we got too much in some areas and not enough in others, but in the 18 sectors I think it can be clearly stated that breakthrough was achieved and we have reengaged the round, and we have a new momentum based on the confidence I think that has been engendered between not only the quad nations, the quad entities, the European Community, Canada, Japan, and the United States, but the G–7. And I would like to report to you that meetings are already being held in Geneva involving not only U.S. representatives, but representatives of other nations as well under the leadership of the new GATT head, Peter Sutherland from Ireland. And Peter reported to me yesterday that in fact there is great optimism.

We know we have a lot of work ahead of us, that this market access agreement in manufactured products is just a beginning. We have to address the issue of services where we did make some progress, which I would be happy to talk about today, the very important issue of agriculture, where we need to make tremendous progress in the area of tariffication and the areas of both current and minimum access, as well as disaggregation and other areas as well, and, of course, the so-called rules, the trade rules, various

areas in that that we are—as you know, the United States is concerned about, whether it is the antidumping language currently in the draft final act or the subsidies portion of the draft final act, other areas as well, including the protection of intellectual property, and so we know this is just a beginning and we are trying to be pragmatic and practical and realistic about what was achieved, but I think it clearly can be said that this President by, one, indicating on February 26 at American University that the Uruguay round was one of the highest priorities of this administration and was a significant part if not a vital part of his economic plan, was a start, that he then asked for the renewal of fast track, which this committee and others in the Congress provided the leadership with regard to in order to get fast track not only through this body but the other body without amendment, which was critical to our credibility in dealing with our trading partners in reaching an agreement.

Next, of course, the President insisted we take up market access in manufactured products and services first, which I think was a wise choice on his part, and insisted that we complete it by the G–7 which gave a real time limit to these discussions. In the meantime the President, as you know, engaged world leaders in continual discussions with regard to completing the market access discussions by the G–7 and, of course, completing the Uruguay round by December 15. Truly this was an area in which the United States, President Clinton, the cooperation of this Congress worked together in order to fully restart a process that was badly, badly in need of some momentum, and I think we achieved that in Tokyo. You know, there is a tendency, Mr. Chairman, to want to overstate what was achieved, especially when you come home and it has been a good week, but I don't think we should do that in this case or in the case of the Japan framework.

I think we ought to be realistic about what we face. This is tough sledding. There are a number of major issues we will face together. This committee has been extremely supportive of the administration on both sides of the aisle, which we appreciate and will continue to work with you on market access issues, on services issues, on agricultural issues, on issues of the rules of the game, so to speak, in order that we can get a balanced and successful Uruguay round package by December 15.

I would like to, before I get into the Japan framework, introduce to the committee my two ambassadors, Ambassador Yerxa and Ambassador Barshefsky who did such incredibly good work in Japan leading up to that. Truly we would not have been able to reach the agreements we reached without them. I think they deserve a lion's share of the credit, and the President has said it and I would like to say it to this committee, and they deserve a tremendous amount of plaudits for what they were able to accomplish in working not only with me, but working with the President in Tokyo.

As far as the Japan framework is concerned, Mr. Chairman, we have indeed, I think, broken new ground. We began these discussions with the Japanese Government on the basis that our economic relations with Japan were not in good order. We had good political relations and they are strong, our security relations have never been stronger, but our economic relations were the third leg

of the stool, which was not as strong as it should be. We decided there were four principles. The President decided four principles that we needed to rely on in order to reach a successful framework agreement, an agreement which would be the rules of the game, which would outline the principles upon which we would work in order then to reach agreements in various sectors or we call them baskets. There are sectors within the baskets, as you know.

The four areas we decided on, we want, one, a results-oriented agreement. No more promises, no more vague statements, but a results-oriented agreement. Second, we wanted quantitative and qualitative measures, and if you look at page 4 of the agreement you will see that in that paragraph. Number three, we wanted five baskets or major areas we had to deal with. One is Government procurement; two, regulatory reform; three we call other sectors and includes among other things auto and auto parts which, as you know, Mr. Chairman and members of the committee, represents about two-thirds of our trade deficit with Japan. Fourth, compliance with existing agreements, and fifth, economic integration, and last, of course, we did not want to have any kind of framework agreement reached that did not have timeframes built into it.

Too many times we have gone on for years and years discussing various issues with the Japanese Government and have been unable to reach agreement. We have a 1-year outside timeframe, 6 months for certain sectors within certain baskets, and then 6 months to finish off all the baskets. I believe that is as important as anything we achieved in Tokyo with regard to the Japanese framework agreement. The ability to say that there is an end to this process was extremely important.

With the permission of the committee I would like to put into the record not only the framework agreement, not only the market access agreement on the Uruguay round, but also the two side letters that were exchanged yesterday morning which were agreed to in Tokyo. The Japanese have reserved the right in specific areas, if we initiate a 301 action, to withdraw from the talks in that specific area. We, of course, made it very clear we reserved our right of course to use all, all national trade laws with regard to Japan or any other country as we proceed with these discussions. We believe—the discussions under this agreement begin around September, right after the Congress comes back, and we are at least hopeful that a new relationship has been established and we will have agreements based upon practicality and reality, not upon sheer hope.

With that, Mr. Chairman, I would be pleased to take your questions. I would like to submit my testimony for the record in order to save the committee time today, and of course I would be happy to answer your questions or questions of any member of your committee.

[The prepared statement and attachments follow:]

Report from the G-7 Economic Summit
Testimony to the House Subcommittee on Trade
Ways and Means Committee
Ambassador Michael Kantor
U.S. Trade Representative
July 13, 1993

I appreciate the opportunity to appear before the committee today to report on the trade aspects of the G-7 summit.

I hope that you will share my view that the breakthrough on the Uruguay Round and the agreement on a framework for negotiations with Japan represent major progress for our country, jobs for the American people and a stronger global economy.

Uruguay Round

Year after year, the G-7 leaders have expressed their view that it was important to finish the Uruguay Round, which began in 1986. As the negotiations languished, it became critically important that this summit go beyond rhetoric, to obtain concrete results which would provide the momentum for completing the Round. I believe that the Quad nations---the U.S., the EC, Japan and Canada---achieved a breakthrough on the Uruguay Round.

We have two major tasks ahead of us to bring the round to a conclusion by year end. We must complete our market access negotiations in goods, services and agriculture and concurrently, we must improve the rule-making agreements contained in the draft "final act." The President's leadership at the Tokyo Summit gives us the opportunity to complete these tasks in Geneva.

I should say that the Tokyo agreement is not a final deal. There is a saying in these negotiations that nothing is agreed until everything is agreed. Nevertheless, the results from Tokyo represent a big step forward where the Quad countries have shown leadership to galvanize the negotiating process in Geneva where our key trading partners now will have to match our efforts to make the market access package a reality in December.

As members of this committee know, the agreement on market access is the result of effort that started in the first weeks of the Administration. At that time, President Clinton made it clear that completing the Round, this year, was among his highest priorities. At his instruction, in February, I began working with my EC counterpart, Sir Leon Brittan, on a joint effort to make progress on market access issues, first between the U.S. and the EC, and then with the other Quad nations, with the goal of reaching the outlines of a far-reaching market access package by the time of the G-7 Summit.

The President repeatedly emphasized with other world leaders, and with finance leaders from around the globe, the need for immediate re-engagement of the Uruguay Round, and the importance of achieving agreement on a market access package by the time of the Summit.

We sought to underscore our commitment to completing the Round by seeking fast track authority only for that purpose, and only for this year. The Congress, led by this Committee, contributed invaluably to our efforts by providing advice, insight and clear sense of negotiating objectives, and by giving the President the fast track authority prior to his departure for Tokyo.

The package from Tokyo contains the following: Quad agreement to the elimination of tariff and non-tariff measures in : pharmaceuticals, construction equipment, medical equipment, steel (conditioned on reaching a multilateral steel agreement), beer and, subject to certain exceptions, furniture, farm equipment,

and spirits. These are the so-called zero/zero initiatives. Most importantly, we agreed that we would work to add other sectors to this list.

We agreed that tariffs on chemical products would be harmonized at a low rate, including, in some cases, zero. Those nine sectors currently represent over $75 billion in U.S. exports -- a figure which should grow substantially under a completed Uruguay Round.

For the remaining products, we set an overall goal of 33 percent -- which was the ultimate tariff reduction goal of the Montreal Accord in 1988 -- but have identified a number of sectors where tariffs could be reduced substantially beyond this level, in some cases, possibly beyond 50%. Our agreement noted that a particular interest of some participants in moving further in such areas as wood, paper and pulp and scientific equipment--- all critical sectors to the U.S. I am committed to trying to go significantly further in reducing tariffs in these areas, as well in the electronics sector, where the EC is willing to consider going beyond 33%, but did not want to do so at this time, and in non-ferrous metals.

Finally, the package addresses "peaks" -- those tariffs that each of the Quad countries maintains that are at or above 15%. Quad countries have on average, fairly low tariffs, but there are some peaks remaining. As you are well aware, there has been attention on U.S. Peaks -- in areas such as textiles, apparel, ceramics and glass. We have offered some reductions in a number of our peak tariffs where our Quad partners are principal or substantial suppliers, after extensive domestic consultations. This approach requires market access as a condition for tariff reductions and MFA phase out, anti-circumvention protections, longer staging and exempts tariff lines in the case where China or Taiwan is a significant supplier.

While the focus in Tokyo was on industrial goods, we agreed that a successful Uruguay Round would require a substantial package of market access commitments in services, the fastest growing part of the global economy and one in which the U.S. has enormous strengths. There has been substantial progress in the services access area. The Quad discussions focused on the remaining areas where further work is needed before success can be achieved: financial services, basic telecommunications, maritime, audiovisual, and movement of personnel. We have a good foundation on which to build in Geneva.

Finally, let me say a word about agriculture, which for the United States remains a central component of a final Uruguay Round package. We agreed in Tokyo that work must proceed in Geneva to finalize country schedules and the details of market access commitments. With the Blair House agreement behind us, market access is the major issue for Geneva negotiations. The United States is at common cause with our trading partners in Cairns who insist that the access achieved at the conclusion of the Round must be greater than the access that currently is being provided. This is a principle that will continue to guide our negotiations.

We agreed in Tokyo to begin immediately in Geneva to make our agreement the first step toward successfully concluding the Round. Our negotiators began yesterday, in fact, the process of meeting with their counterparts in other nations to explain what was done in Tokyo, and to discuss with them their offers on reduction or elimination of tariff and non-tariff barriers. We have said repeatedly that the United States is prepared to do its share for a successful Round; our Quad partners have demonstrated some of the same determination. But many nations involved are going to have to contribute as well in order to reach the result that will benefit all of us.

The Round is not a favor that we are doing for the rest of the world. The USTR and the Council of Economic Advisors estimated in 1990 that if we assumed a one-third cut in global tariffs and in reductions in non-tariff barriers as well, it would translates into an average additional $1,700 a year for a typical family of four.

Framework for U.S.-Japan Negotiations

The other order of business in Tokyo was the effort to agree on a new framework for negotiations with Japan on the sectoral and structural issues that have hampered our exports, and those of other nations, to Japan, and caused damage to what may be our most significant bilateral relationship.

Along with completion of the Uruguay Round and the NAFTA, the principal trade policy objective of this Administration has been real progress in improving the unbalanced trading relationship we have with Japan.

Japan still represents a market that is dramatically less open than ours, and significantly less open that it should be given the size of its economy and the state of its development. The relative absence of tariff barriers is less significant than the bewildering array of non-tariff barriers that make success in the Japanese market so hard to come by. In case after case, U.S. products and services which are coveted around the world achieve negligible success in Japan.

The President stated eloquently in his Waseda University speech, as we seek a more open, consumer-oriented Japanese economy, we are taking steps that benefit not only the U.S. but the people of Japan, who are being deprived of the rewards they deserve for their hard work and accomplishments.
The framework we agreed upon commits Japan to significant reductions in their current account surplus with the world, significant increases in their global imports, and the U.S. to a significant reduction in our budget deficits. It sets the stage for negotiations on autos and auto parts; government procurement; and regulatory reform. It provides for full implementation of existing agreements and commitments.

The agreement addresses the four basic concerns articulated by the President:

1) a results oriented policy;

2) quantitative and qualitative measures;

3) the intersection of sectoral and structural approaches within each basket; and

4) articulated time frames to complete negotiations.

This is a framework for future negotiations. By itself, it constitutes no market opening, guarantees no future success, and represents no panacea for the bilateral differences that have characterized our relationship with Japan. Hard bargaining on important issues remains, including the enforcement of agreements already in effect. We intend to make progress, and recognize it will not always be easy. We are committed to the utmost efforts to obtaining results under this framework, but if the consultations and negotiations under the framework do not make the requisite progress, we will not hesitate to use other approaches that Congress provided in the trade law.

Conclusion

I recognize that for the recent college graduate looking for his or her first job, or the young African American in an inner city

trying to escape a vicious cycle of poverty, or the mill worker who's been laid off, or the farmer in the midwest struggling to make ends meet, the Uruguay Round and the Japan framework may seem to have little relevance to their lives.

But as I said at my confirmation hearing in January, there is nothing academic or theoretical about the job that the President has asked me to do. Every billion dollars of exports creates twenty thousand new jobs in the United States. These are good jobs, too; a majority of them are in the manufacturing sector and earn, on average, almost $3,500 more than non-export jobs. For service workers in export-related fields, their paychecks are 20 percent higher than average service worker's salaries.

Our prosperity and that of our children depends on our ability to compete in the new global economy, in which the United States is inextricably linked.

We are the world's largest exporter; we set the standard for the world in areas as diverse as computers, machinery, movies, agriculture, architectural services. We have nothing to fear from open markets and a level trade, because we are such strong competitors. The objective of trade policy is to insure that our trade laws are enforced, that nations are held to the agreements they reach with us, and that the markets of other nations be as open to our products and services as our market is to theirs.

Last week, in Tokyo, we made significant progress in our effort to open markets around the world.

EMBASSY OF JAPAN
WASHINGTON, D. C.

July 12, 1993

Dear Ambassador Kantor:

With regard to the joint statement of July 10, 1993 by Prime Minister Miyazawa and President Clinton on the establishment of the Japan-United States Framework for a New Economic Partnership, I wish to state the following Government of Japan position with respect to certain limited U.S. Government trade actions, such as Section 301 of the Trade Act of 1974, as amended.

The Government of Japan will utilize this Framework as a principal means of addressing bilateral trade and economic issues. The Government of Japan reserves the right, however, to withdraw from any particular structural or sectoral issue which, following consultations under this Framework, remains subject to dispute, in the event formal procedures under the above-referenced actions are initiated. The Government of Japan also reserves the right to suspend or nullify measures taken with respect to the issue under dispute in the event that action by the U.S. Government is taken with respect to that issue to restrict access of Japanese firms to the U.S. market.

Sincerely,

Takakazu Kuriyama
Ambassador of Japan

The Honorable Mickey Kantor
United States Trade Representative
Office of the United States Trade Representative
Washington, D.C. 20506

THE UNITED STATES TRADE REPRESENTATIVE
Executive Office of the President
Washington, D.C. 20506

His Excellency Takakazu Kuriyama
Ambassador of Japan
2520 Massachusetts Avenue, N.W.
Washington, D.C. 20008

Dear Mr. Ambassador:

I acknowledge receipt of your letter of today's date with regard to the joint statement of July 10, 1993 by President Clinton and Prime Minister Miyazawa on the establishment of the United States-Japan Framework for a New Economic Partnership. I wish to state that the U.S. Government will utilize this Framework as a principal means for addressing bilateral trade and economic issues. The U.S. Government reserves all rights, however, with respect to the application of all national laws, including all statutes, regulations, and rules pertaining to international trade.

Sincerely,

Michael Kantor

Chairman GIBBONS. Well, thank you, Mr. Ambassador. Without objection, we will receive your testimony in full and place it in the record, and we will take those two exhibits that you wanted to introduce and introduce them at the appropriate place in the record. Without objection, so ordered.

Mr. Ambassador, as I see it, you have got 5 months in which to complete the Uruguay round. Can you get it done in that time?

Mr. KANTOR. I believe two or three things happened, both leading up to Tokyo and in Tokyo that gives me at least the confidence that we have the best chance we have ever had to complete it and I believe we will. Let me explain that, Mr. Chairman. Number one, I think the United States and its trading partners have developed a new confidence in each other that we can actually reach agreements through hard bargaining and move the round forward, and I think that was a major accomplishment in Tokyo.

Number two, there were some very difficult issues, as you know, involved in the market access agreement on manufactured products. We negotiated in a 17-hour period for 12 of those hours with only a few hours off for drafting and 1½ hours sleep, and I think that the compromises that were reached, the kinds of tradeoffs that were made also were helpful in terms of moving this forward. Number three, we did make progress in the services area, especially financial services, which is a difficult area, as all of you know; and number four, there is general agreement among everyone that we need to immediately begin to engage in talks as we have in Geneva.

All that being the case, I am more than hopeful. I am confident that we can reach an agreement by December 15. Understand what I am saying. This has been going on for 7 years, but for 7 years no one could reach a markets access agreement in manufactured products, and I think the news reports out of Geneva and the talks I have had with people there over the last 48 hours give us that confidence.

Chairman GIBBONS. Well, what other major signposts along the road should we be looking for as to the progress of these talks? You have got agriculture. Is that completed?

Mr. KANTOR. No, not at all. We have just started, and we have a schedule of discussions on agriculture which we are trying to finalize right now. That is one of the more difficult, as you know, areas that we have to address. The Cairns group, led by Australia is cooperating with us closely. We have similar interests and we are working hard to achieve an agricultural agreement. We have some concerns over the French trying to reopen the Blair House agreement, the United States although not totally satisfied with the Blair House agreement, believes that reopening that agreement would not be in the best interests of completing the round by December 15.

We hope that we can convince not only the French Government and others that we should leave the Blair House agreement intact and deal with the problems that the French or others might have in the market access agreement in agriculture which we must reach, of course, by December 15. We have some issues we have to address. One has to do with current access, one has to do with minimum access, the third has to do with disaggregation, and last, of

course, is to have a real tariffication schedule which opens up markets to the most productive agricultural community in the world, which is the United States.

We believe we can do that. We believe that we can deal with our trading partners in agriculture as we did in manufactured products, but let me not overstate the case for this committee. There is some tough bargaining ahead, and we are going to need your help, advice, consultation, and guidance as we proceed.

Chairman GIBBONS. Trade in services. Standing on the outside looking in, the services negotiations seem to be going off on a track all their own. Certain regulatory agencies in existence around the world, on ships, aviation, things of that sort, seem to be interested in preserving the status quo. What do you expect in the area of services? Are we going to go forward on a GATT arrangement or are we going to go forward on a multitrack arrangement?

Mr. KANTOR. In some cases there is a multitrack arrangement, but the timing is such that we hope to end them at the same time that we end the Uruguay round. Shipbuilding is certainly one of those. Telecommunications is another. However, in the areas of audio visual, in the areas of financial services, and in other areas in the services area we think we can reach agreement. Financial services is a critical area to open up. Audio visual area right now needs—or intellectual property needs some work. We have some deep concerns with regard to contract rights and national treatment, and we will be dealing with those.

As you know, it affects not only the pharmaceutical industry in some cases, but also one of the most productive industries we have, the entertainment industry, and we mean to pay strict attention to that in the services area. However, we have made some progress, some of which I would rather not discuss in public, but we have made progress in many of the service areas.

Chairman GIBBONS. Well, I am going to be brief because we are going to have to be out of here at 12:45. Our order of questioning this morning is Payne, Crane, Coyne, Matsui, Neal, Hoagland, and Thomas. Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman, and Ambassador Kantor and Ambassador Barshefsky and Ambassador Yerxa. You have been very busy since you were here last and you have accomplished a lot and we appreciate your accomplishments. I wanted to take a few minutes that I had just to talk about a subject that we have spoken about before, and it has to do with the textile industry and what exactly has transpired in terms of the GATT agreement.

I recognize that we are not in a position to discuss all the specifics here. If you would, for my benefit maybe start from where textiles were when you began these negotiations and then to talk about where we are at this point and where you think that issue may go, I would find that to be very helpful.

Mr. KANTOR. As you know and as we have discussed, not only with you and your colleagues in the textile caucus, but also with the industry as well as the unions, when we came into office there was an offer on the table which would have involved an across-the-board cut in peak textile tariffs as well as nonpeak tariffs of 50 percent. We withdrew that offer for a number of reasons.

One, it did not have the condition that market access be required in order to have any cuts not only in tariffs but also for the imposition of the—or the phasing out of the multifiber arrangement. We have insisted upon that, and we have an agreement at least with the European Community right now and the quad as well as now the G–7 on that.

Number two, we insisted that there be anticircumvention language, strong language in this.

Number three, we indicated that any offer we made in terms of any tariff cuts would only be on peaks, 15 percent or more, and that we would do it on a line-by-line basis, not 50 percent across the board, and that we literally did that. We went through about 900 lines in textiles and apparels, and what we tried to do is, one, only deal with those that were—where the European Community was the principal and substantial supplier, but, number two, we cut out of that any lines where China or Taiwan, frankly, were significant suppliers for obvious reasons, and so we have changed the offer and the agreement substantially.

I would like to report to you that the European Community and others were satisfied with that and will not push for more, but that is not the case. They will, they will try to push for more as we go forward. At this point, though, that is what has been agreed to, and that is what the package reflects.

Mr. PAYNE. As we go forth I want to continue to have the opportunity to discuss, as we have in the past, where this currently is and where it is going. I will be very interested in the documents that you put into the record and I think they will be very helpful. But I would again like to say that the textile industry, being a very large industry certainly in the Southeastern part of the United States as well as other places as well is concerned about the GATT agreement and specifically about tariffs. We feel that in terms of the multifiber agreement and the fact that quotas have been—will be taken off over a period of time, that that is a very substantial change in terms of the relationship that we have with our trading partners.

We, of course, continue to be very interested in market access, especially in countries where we have no access in India, Pakistan, and other nations like that, but I want to continue to stress that there are strong concerns about tariffs and tariff reductions and would like to continue to work with you as you continue to negotiate to ensure that the textile workers and the textile industry is given every consideration because this is very critical to us and to the future of our people. Thank you very much.

Mr. KANTOR. Thank you, Mr. Payne. Let me just say that everything we are trying to do in this administration in trade agreements, whether it be in the specific sector of textiles and apparels or in the Uruguay round of the Japanese framework has to do with one thing, and that is jobs, and we understand that is our obligation and our responsibility is to not only preserve but to build jobs here at home. We believe what we are able to do thus far in the textile and apparel area not only preserves but builds an industry and helps it progress, and we will continue to work with you obviously and the caucus as well as this committee, as well as with the

industry, as well as with the unions in attempting to reach a balanced outcome that is in the best interests of U.S. workers.

Mr. PAYNE. And we will look forward to seeing the specifics as they develop. Thank you very much.

Mr. KANTOR. Thank you, Mr. Payne.

Chairman GIBBONS. Mr. Crane, and I understand that Mr. Coyne has yielded to Mr. Thomas, so we will go to Mr. Thomas after Mr. Crane.

Mr. CRANE. OK, thank you, Mr. Chairman. Mr. Ambassador, in your view, how much of the U.S. bilateral trade deficit with Japan is caused by our large budget deficit?

Mr. KANTOR. Let me say this—let's put it this way, it is very difficult to say out of the $50 billion deficit what percentage is due to our deficit or our lack of competitiveness in the past. Let me say American industry has never been more competitive than we are today. Obviously, the President believes and I think you believe we must address our deficit problem, which this administration is trying to do. We must invest in our people again, we must create capital for private industry to be more competitive, to be able to engage in effective trade around the world. We have got to get our health care costs under control.

Now, that is one part of the problem, but the other part is certainly closed markets in Japan in vital areas. Let me just give you one example of that. We imported about $97 billion of goods in Japan in 1992. We exported about $47 billion. I think you cited that in your statement, for a $50 billion trade deficit. Of the $97 billion, 65 percent were only in six areas—electronics and semiconductors, auto and auto parts, computers and supercomputers, which is a fairly stunning figure. When you look at our situation in Japan with regard to those six areas, they are six areas where we are relatively locked out of even the Government procurement market or the private market in some cases, and we are talking about the second largest economy in the world. So to a great degree and some have estimated it is as high as $19 to $20 billion in a recent book of our net trade deficit with Japan is due to that closed market, so you can, and I know you do, understand what would happen if we opened that market up, and I think in fact Fred Bergsten is here later and I think he would talk about that. If we could open that market up not only in those six areas but others which are part of these baskets, we could build a huge number of jobs here, help American business, of course, and balance this trade.

In our Japanese framework we talk about highly significant decreases in their trade surpluses with the world. What we really want to happen, of course, is bring that down to zero. I would only offer by example over the years we have had a balanced relationship with the European Community. Sometimes they have a trade surplus, sometimes we have a trade surplus. It is due to a number of factors, including exchange rates and the relative strengths of the economies and so on, but with Japan what has happened over the years, the trade surplus continues to get bigger and bigger. That is not just due to in the past some of the problems we had. Not anymore. As I say, in American business, in America workers have never been more competitive. It is due to basically closed mar-

kets and the closed procurement system which must be opened. We believe the framework we have entered into only being a first dip, only constituting the rules of the game is a good step, though, towards having a results-oriented policy which will be good for American business and American workers.

Mr. CRANE. One of those component parts of improving this relationship, as I understand it, is to adopt at least general guidelines with respect to import quotas in various sectors, and if we do that, how do we assure that those don't become limits on growth of our exports in that market down the line?

Mr. KANTOR. There are no quotas. We don't intend for them to be quotas.

Mr. CRANE. Maybe not precise quotas.

Mr. KANTOR. They are really quantitative and qualitative targets in which we try to measure success. What we hope to do is stimulate trade, not manage it. What we hope to do is open up these markets, develop a critical mass, as frankly has been done under the semiconductor agreement where then these measures of success will be no longer necessary because we will become such a part of the Japanese economy, our suppliers and the products made by our workers that you will no longer have the need for these kinds of agreements. We will have the kind of relationship that we have, for instance, now with Canada where we have 200 billion dollars' worth of trade a year, and as I said sometimes we have a surplus, sometimes they have a surplus, but the fact is it is a balanced relationship.

Mr. CRANE. Affirmative action, not quotas.

Mr. KANTOR. I wouldn't touch either of those terms, Mr. Crane.

Mr. CRANE. One final question, and this has to do with increasing markets there and the participation of some of the people in the Japanese bureaucracy who are in a position to dictate purchasing decisions by Japanese companies. As I understand it, with this change in the Government and the flux that is going on there right now, what kinds of agreements do you think are negotiable at the present time?

Mr. KANTOR. Well, number one, we think the framework agreement is a good solid one we just negotiated. Now, understand that is the rules of the game and not an agreement. Their election will be held July 18. There will be, under any set of circumstances a new government. There will be new people in office. We all understand the influence the Japanese bureaucracy has over decision-making. That will substantially remain the same as the prediction regardless of the outcome of the election. However, I think there is a growing trend which the President noted and talked about in Japan in terms of consumer interest.

You know, it is in the best interest not only of our country but Japan to open up these markets. It should not escape anyone's attention that prices in Japan are much higher because of lack of competitive goods. Let me give you an example which was stunning to me as we were in Tokyo. In most American groceries you can walk in and get a jar of pickles for about $1.83, $1.85; $10 in Japan. A sparkplug in Japan, $14; less than $2, of course, here in the United States. Just two, I think, fairly vivid examples of what

happens when you close the market, don't have competition and who gets hurt?

In Japan it is the consumers who get hurt, and I believe there is a commonality of interest between American workers and Japanese consumers to open these markets and expand trade for the good of not only these two countries but, frankly, for the good of global growth.

Mr. CRANE. Well, I thank you for your testimony, and appreciate the work all three of you have been doing and just to reconfirm a comment that Rufus made earlier, please don't forget bilateral agreements, especially with our Pacific Rim neighbors. Thank you.

Chairman GIBBONS. All right, Mr. Thomas, courtesy of Mr. Coyne.

Mr. THOMAS. Thank you very much. I thank my colleague for yielding. I will be very brief. We started a Health Subcommittee at the same time as this subcommittee and we are looking at the potential global budgets question. Mr. Ambassador, I would like to submit for the record a series of questions about alleged phytosanitary concerns that are really, in my opinion, being used for nontariff barriers and rather than take the time, I would hope we could get a response back from you. Pickles and sparkplugs are an interesting combination in terms of shopping, but I would like to——

Ambassador KANTOR. It shows I am somewhat eclectic, Mr. Thomas.

Mr. THOMAS. I will try to find a link between the two.

Ambassador KANTOR. I hope you don't.

Mr. THOMAS. I would like to just ask you to elaborate a little bit on the final question by my colleague from Illinois in terms of the politics. We are used in this country to transitions, either potential or actual transitions, and while it is true to a certain extent our bureaucracy remains the same below a certain level as well, I think it is more than that with this election in Japan, and if I am wrong, having been on the ground firsthand as the campaign was heating up and in the last couple of weeks of it, is the question of the consumer and the value of products part of the campaign, and if the LDP beats back this challenge, which won't be the first one that they have been able to, do you see obviously a change in the leadership?

You can pick up feelings and intimations from those people that you were working with which we were not able to pick up nor do we get through the media. My question is, I guess, do you see a change regardless of who wins and especially if there is a change in the Government, and what prompts you to use the consumer concern analysis and was it based upon your observations during the election and could you give us just a bit more of a feel from your personal observations of dealing with people who may or may not be in the same position the next time you meet.

Ambassador KANTOR. If you would allow me to be somewhat cautious in talking about someone else's internal political elections, I think it would be unfortunate if I began to wax ineloquent about Japanese politics. I have been there twice in the last 3 weeks, but that does not make me anything near an expert nor, in my present position, would it be productive for me to be too explicit. However,

I can report both in private conversations and frankly in the newspapers in Japan there is a growing discussion and debate about consumerism in Japan, the plight of the consumer, prices, open markets.

The challenge to the LDP in part, let me be careful, in part has some of those qualities. Obviously the other concerns are of a much greater nature, and that includes reforming the Japanese Government itself, political reform being at the top of the list in terms of their discussions. I don't know what the outcome is going to be. However, it is safe to say that there are a number of young Japanese leaders coming to the forefront whose attitudes toward trade with the United States and the world may be somewhat different than leaders in the past.

I would note with interest a report in one of our local newspapers this morning from a conference in Cleveland where Japanese business persons indicated that they should open their markets as well. I think that is a welcome statement and one that certainly tracks what we—this President has been trying to do and this Congress has been advocating for quite a while, so with that I think there is a direction that is positive. Whether or not it will be fully realized is another question, and we will just have to wait until July 18 and see what the outcome is.

Mr. THOMAS. Thank you.

[Answers to questions submitted by Mr. Thomas follow:]

ANSWERS TO QUESTIONS SUBMITTED BY CONG. BILL THOMAS

JULY 13, 1993

1. Which of the five principle areas of the new framework for negotiations with Japan would allow the U.S. to seek resolution of phytosanitary, labelling and health issues: regulatory reform, economic harmonization or "other sectors"? What procedures will be used to discuss and resolve disputes thin these areas?

Answer:

The Framework is not meant to be the exclusive focus of all trade discussions with the Japanese. Many issues, such as apples for example, have been and will continue to receive concerted attention from the USG outside the Framework context. Several agricultural issues will fall into this category. Others may well fall into the regulatory or compliance basket discussions. The exact content of these Framework baskets has not been determined.

The Trade Committee meetings with Japan in mid-September traditionally offer an excellent opportunity to tackle difficult agricultural issues with the Japanese.

2. How will existing disputes, such as disagreement over whether Japan is scientifically justified in excluding U.S. apples because of "fire blight", be handled under the new framework? If these disputes are not to be settled under the new framework, will the U.S. continie to try resolving these issues on a case by case basis?

Answer:

The Framework is not designed to include all existing or future bilateral trade issues. To include all issues would unnecessarily delay resolution of many issues such as apples. As you may know, we have been unrelenting in our pressure on the Japanese to move forward and resolve phytosanitary issues regarding apples. The Framework is really designed to negotiate new agreements and to assure compliance with regard to existing agreements.

Many trade issues will continue to be handled outside the Framework. Moreover, continued high level meetings of senior officials in the Framework context will offer many opportunities for side meetings on a host of other issues.

3. How will the new framework address disparities in treatment of pesticides residues, phytosanitary matters and labeling? For example, Japan allow only 200 ppm of sorbate in wines (the U.S. standard in 300 ppm) while allowing dried cuttlefish sold as food to contain 2,000 ppm). Are there plans to include this issue in the discussions under the framework and how will it be resolved?

Answer:

We expect that a number of issues such as these will be addressed in the Trade Committee meetings to be held with the Japanese in September.

Chairman GIBBONS. Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman. Welcome, Mr. Ambassador and congratulations to you and your team for the work you have done in Japan. How does this homework differ from previous bilateral negotiations between the United States and Japan? We had the market-oriented, sector specific talks, the MOSS talks, and we had the structural impediments initiative. How is this going to differ from those previous efforts?

Ambassador KANTOR. Number one, it is results-oriented strictly; number two, we have quantitative and qualitative measures; number three, what we have done in these baskets and sectors is to intersect structural and sectorial concerns. In the past, as you correctly noted, we had dealt with them separately, structural on one hand, sectorial on the other, and in fact when you look at reality, where they cross is where the problem occurs, and so we have tried to do those three things. We have done one more thing that I think is obviously important. We have put a time limit on these discussions, which puts some pressure on both sides to reach agreements which are in the best interests not only of United States-Japan economic relationships, but global growth.

As you know, we are negotiating on an MFN basis, not just for the United States, but to open Japanese markets to all foreign suppliers. That is another unique nature of these negotiations, but let me emphasize again, we have got some hard bargaining to go. These are only the rules of the game, and I would not sit here in front of you today and tell you that we have been able to accomplish anything in any particular sector. We haven't. This is what we have got to do in the next year, 6 months and 6 months, but the idea that we have a timeframe, the idea we have crossed sectorial and structural concerns and put them in the same negotiation, that we have qualitative and quantitative targets and we are results-oriented, are all different from what we have done in the past, especially putting them all together in one package.

Mr. COYNE. Thank you very much.

Ambassador KANTOR. Thank you, sir.

Chairman GIBBONS. Mr. Matsui.

Mr. MATSUI. Thank you, Mr. Chairman. I would like to commend you, Ambassador Kantor, and your entire negotiating team, along with the President and the administration for the success of the Tokyo summit. I think expectations by most people in this country and elsewhere were very low, but I think the GATT movement and the framework agreement were significant achievements, given the fact that many of the leaders have very fragile leadership roles in their various countries. I want to ask a couple questions with respect to the United States-Japan agreement.

The President gave a speech in Tokyo at a university regarding encouraging the Japanese to look to the consumer side of the equation in their economy more. Was that well received and what was the impact of that from your perspective? Could you state your thoughts on that.

Ambassador KANTOR. Number one, it was, I think it would be safe to say the President made a very significant impact in Japan as well as did the First Lady. His speech at Waseda University was received unanimously by the Japanese commentary, being Japa-

nese newspapers, as being very helpful and forward looking that connected to the successful outcome of these negotiations on the framework. I think it has given everyone the confidence that we can really strengthen this economic relationship.

I think it was somewhat both interesting and maybe eye opening to Japanese politicians to see another political figure stand not only and make a speech, but answer questions as the President did from students at Waseda University. That was striking and got as much comment, frankly, as the speech itself. The openness of his comments, the direct nature of what he was trying to say, the zeal with which he said it, and then, of course, the ability of our negotiators led by Bo Cutter at the White House and Larry Summers and Roger Altman at Treasury, Joan Spiro at State and, of course, Ambassador Barshefsky, made this thing come to life, and so all that being the case, I think it can be fair to say that the comment was all positive from Japanese newspapers.

Now, of course, those running for office in Japan were quick to put their own spin on this issue, and we expected that to happen, but we are moving forward with this framework and these negotiations.

Mr. MATSUI. I appreciate those remarks because I think even though the interpretation in terms of the phrase "objective criteria" may differ between our two countries, I think once we go into the discussions with the Japanese in negotiations, we will see further movement in our direction. I appreciate the fact that there may be some nuances that are different at this time. I think this is a major step in the right direction and a step that is very timely.

What I also noticed, at least from the article that appeared in one of the national newspapers yesterday, is that for the first time there has been some dissension within the bureaucracy in Japan in terms of what direction to take. I did notice that while there was dissension among the Japanese negotiators, our negotiators were very unified in terms of our direction, and that also is somewhat of a first for us, getting all the different departments and the White House to agree.

I have two thoughts in this area. First, I would like to know as these negotiations actually transpire, what will be USTR's role in the discussions with the Japanese and what role in terms of our dominance does USTR play. Second, it would be my hope that if the negotiations should break down or should not go as well as we would anticipate, given the timetable that we set, then would we consider leveraging our position with linkage with or support of, for example, the Japanese entering the Security Council of the United Nations. I think we have to begin to link some of these items over a period of time because, frankly, this is our one shot. I think if these are not successful discussions you will probably see a significant protectionist sentiment come out of the House and the Senate because there is anticipation at this time, and I don't know if the Japanese truly understand that. A lame duck prime minister cut a deal that we think is fair, but they are going to go into an election. It would be my hope that we would consider linkage on some of these other areas that they truly want. They truly want to be a member of the Security Council and we have supported that effort. If in fact we can't get relief in terms of some of the things that

we think are fair, perhaps these other areas should be up for discussion as well. But I would like to know, one, your primary role in terms of the actual negotiations and, second, your thoughts on linkage with other areas.

Ambassador KANTOR. Number one, this Government under this President is unified in trade, and I think it never was more evident than in these negotiations, both the Uruguay round, the framework, and also the G–7 talks. You know, it has been a long time since the USTR went with State and Treasury to a summit, and I have got to say I am deeply grateful not only to the President, but also to Secretary Christopher and Secretary Bentsen for ensuring that that occurred and for being so cooperative. In terms of the so-called baskets and procurement and compliance, USTR will take the lead. In others it is more appropriate for other agencies to take the lead, but frankly because of the great work of Bob Rubin and the National Economic Council and the leadership of the President, we all worked so closely together, it is very difficult to determine who is taking the lead in these negotiations.

As we proceeded in Tokyo, I could say that in every meeting, including with the President, all the negotiators are there, not only Ambassador Barshefsky, but all the others that I mentioned, and so there is no differentiation between agencies as we proceed in trade in this administration, and I am deeply grateful to my colleagues in the Cabinet for their graciousness, frankly, in sort of almost historic openness to having USTR being at the table with them, and I think it worked well and will continue to operate in that fashion.

Mr. MATSUI. In terms of the linkage with these other issues, again you may not even be able to respond, because it is a policy decision that the administration would have to make, but I would hope that there would be consideration.

Ambassador KANTOR. I think the one thing I would say without getting directly into your question in trying to be fairly careful here, our relationship rests, as I said, on three legs of this stool, our political relationship, our security relationship, and, of course, our economic relationship. Two of those legs are very strong. One, of course, is not as strong, and that is our economic relationship with Japan. Obviously a stool tips over if one of the legs is not as strong as the other two, and the President has said that publicly. We continued to talk about that to the Japanese Government, and I think we all assume that unless we get our economic house in order, then, of course, the relationship is not as strong as it should be. This is the most important bilateral relationship this country has. We ought to make sure it is as strong and enduring as it has been in the past.

Mr. MATSUI. I really appreciate that. I have to say that the Japanese are lucky the agreement was negotiated because, as I indicated, if these negotiations should break down or if we don't achieve the goals that we want to achieve, it is my belief that we would become very, very protectionist in 1994. I would put those people you are going to be negotiating with on notice that there is a sentiment out there that I think you successfully abated, at least temporarily, while these discussions go on.

I would just like to move very quickly to address GATT, Mr. Chairman, as I think significant achievements were made in Tokyo with respect to the GATT. At the same time I think we have a long way to go. Trade and services, intellectual property, and many of those things that you mentioned are still on the table for discussion.

One of the concerns that I have, and I am only going to bring this up because it relates to the GATT, is that NAFTA will be coming up probably in the late fall of this year, and should NAFTA fail or be postponed because of the lack of support in the House, I would suspect that there could be serious GATT repercussions. I would like your thoughts on that because you are going to have your hands pretty full with the Japanese negotiations, the GATT, and also your involvement with NAFTA. I think too many of my colleagues, at least at this very early stage of NAFTA, think that NAFTA is a free ride. They think they can vote no on NAFTA, and it is not going to have any implications beyond a no vote, but it is my sense that these are somewhat related and the repercussions could be serious.

For example, I would imagine that if NAFTA goes down, the Japanese might say, gee, there is some weakness in the U.S. trade agenda. There is no coordinated trade effort by this country. Would you comment on that?

Ambassador KANTOR. Well, yes, sir, I will. Number one, I will say that this agenda will keep us all off the streets and out of trouble, at least, for this year. There is no doubt about that. Number two, it is clear to me that the ability to create the largest market in the world, that is through NAFTA with these supplemental agreements will make a big difference in terms of our ability to negotiate successful agreements in the GATT. Truly the rest of the world is watching NAFTA very closely, and they believe, of course, that NAFTA would make the United States much more competitive and therefore they would be much more likely to want to enter into these agreements with us and we would have much more ability to hold our own in these negotiations with the largest market in the world.

As you know, we are no longer the largest market in the world. The European Community is, and so I couldn't agree with you more. That is just one more factor that drives this administration toward trying to get the NAFTA and the supplemental agreements approved by this Congress prior to, of course, the December 15 day, which is the end date on the fast track legislation for the Uruguay round, so I agree with what you are saying and that is just one more reason why we are so intent upon finishing these negotiations led by Ambassador Yerxa on NAFTA and the supplemental agreements in order to get that package to the Congress.

Mr. MATSUI. I would like to thank you, Ambassador, and your entire team. You did an excellent job. Thank you.

Ambassador KANTOR. Thank you, Mr. Matsui.

Chairman GIBBONS. Mr. Neal.

Mr. NEAL. Thank you very much, Mr. Chairman. I, like the other members of this committee, would like to congratulate you, Mr. Kantor, in what seems to be some tangible success. There are many of us here who have opted for more vigorous position as it

relates to our trade practices with the Japanese, and I would like you to, if you can for a moment, comment on a statement that you offered on June 30, and it seems to me that this statement gained you some bargaining latitude. You simply suggested that:

> * * * today I am formally identifying Japan, pursuant to Title 7 of the Omnibus Trade and Competitiveness Act of 1988, as a country that maintains in Government procurement of construction, architectural and engineering services a significant and persistent pattern of practice of discrimination against U.S. products or services that results in identifiable harm to U.S. businesses.

It seems to me that tactically that was a wise position for you to carry going into those negotiations.

Would you give us kind of an insider's perspective on how that strategy developed and how you were able to utilize it to at least demonstrate, I think, some moderate success?

Ambassador KANTOR. Number one, we didn't think it was entirely productive to have invoked sanctions as a result of Title 7 with regard to construction as we moved into a critical timeframe in terms of negotiations not only on the Uruguay round where, of course, Japan is part of the quad and a vital part of it, and also on the Japanese framework discussions and also because the G–7 is in Tokyo and also because of the political situation in Japan and with the President going there but, number two, let me make sure you understand. We have insisted that, one, the negotiations over central Government procurement of construction, architectural, engineering services be put within the framework of the requirements we have put on the table, and that has been agreed to; number two, on November 1 if we have not reached a satisfactory agreement, we will invoke sanctions; and number three, the construction is not part of these baskets or framework agreement we entered into in order to preserve our ability to go forward. So on one hand I think it was hopefully wise on the part of this administration not to invoke sanctions at that particular delicate point, but we have preserved all our rights and November 1 is the end date and the Japanese understand that, and we are continuing those negotiations.

Mr. NEAL. It just seems to me strategically that you opted for the right position in terms of negotiating, that my sense is that this administration is taken seriously now and that the Japanese, given the changes that are occurring in their Government, I think are obligated to take us more seriously. That has been a running criticism that members of the House like myself have had, that there is a period of peaks and valleys to our seriousness as we approach these trade negotiations, and many of us, again, who would like to support the concept of free trade and find it very desirable, but free trade has to be fair trade, and my sense is that you at least accomplished the position of getting them to take your position seriously.

Ambassador KANTOR. I appreciate that. We have tried, of course, to call upon other nations to engage in comparable action. We have not shied away from, for instance, with the European Community invoking sanctions under title 7 with regard to their procurement practices. We have invoked our rights under special 301 during this administration. We, obviously, as you discussed the construction issue with Japan, we are doing an in-house review for the first time ever which we will complete on Thursday, and then go inter-

nally into the administration of all our trade agreements to see which ones are being complied with to see whether to initiate 301 actions or other actions with regard to any other kinds of discrimination. We don't do this just to be doing it. It is part of trying to, as you say, level the playing field.

We are calling upon other nations to engage in comparable action. I believe, and I think my colleagues believe and this President believes that these trade laws are on the books to be enforced, and that is a major part of what we do here. It does us no good to enter into trade agreements if they are not adhered to but let me end by saying that as a result of these and other actions it has been suggested I should not run for prime minister of Japan.

Mr. NEAL. I will endorse you. That would help me in my district. The second question I have is understanding that you need considerable latitude in the negotiating period, you did state or it was suggested that our goal was to get the Japanese to reduce their current surplus of 3 to 4 percent to 1 to 2 percent of the GDP, and it is apparent that you were not able to come back with that position and I am wondering if that was a sticking point during negotiations or whether or not that was just a chit that was thrown on the table for the purpose of, again, getting them to focus on our issues.

Ambassador KANTOR. Well, number one, we wanted to go to zero, that is number one. Now, in the medium term we want a highly significant decrease. There are no numbers in there. We believe highly significant means we will go back to historic levels. That has been about 1.5 percent on the average in the last 20 years of their trade surplus to their GDP, and that is what we expect to happen in the medium term. That is what we think is highly significant. It would not be highly significant if their trade surplus was a greater percentage of the GDP than the historic level and so that is what we were talking about. Obviously as you go through these negotiations, I need not, I think, be any more explicit than saying there are areas that you need to be—that you need to deal with explicitly and others that don't need to be dealt with explicitly because they will—it is clear what you mean. In terms of qualitative and quantitative measures, in terms of the five baskets, in terms of the timeframe, we thought we needed to be explicit.

In terms of reducing their trade surplus and increasing exports into Japan, we believed the language makes it very clear what we expect.

Mr. NEAL. Thank you very much, Mr. Chairman. Thank you, Mr. Kantor.

Ambassador KANTOR. Thank you, Mr. Neal. Appreciate it.

Chairman GIBBONS. Mr. Hoagland.

Mr. HOAGLAND. Thank you, Mr. Chairman. Ambassador Kantor, Fred Bergsten and Marcus Noland have recently published a book called "Reconcilable Differences?", assuming that the differences are reconcilable and not irreconcilable, but in any event the book indicates that—this is a comprehensive new study of United States-Japan economic relations by the Institute for International Economics, and the authors indicate that Japanese market access barriers are limiting American merchandise exports by an esti-

mated $9 to $18 billion annually, of which $6 to $11 billion are in manufactured products, with most of the remainder in agriculture.

In other words, if the market barriers are limiting American exports by an estimated $9 to $18 billion, about a third of those are in the agricultural sector. They note on the other hand that current American trade barriers appear to have little impact on Japanese sales to this country, so right now it is very much a one-way street.

Ambassador KANTOR. Yes, that is right.

Mr. HOAGLAND. I have here the joint statement negotiated in Japan, the joint statement on United States-Japan framework for a new economic partnership, and I don't see the word "agriculture" appearing anywhere in here, and I wonder if you can assure us that the framework text, while not specifically referring to agriculture, includes, is intended to include agriculture in the market access sentence. Am I right?

Ambassador KANTOR. First of all, let me say most of the agriculture barriers can be, which we are, dealt with in the Uruguay round in the agricultural discussions which have started in Geneva. That is number one, in order to open up the Japanese market, and that is important to us in the agricultural area. Obviously we have done very well in citrus and beef once those markets opened, as you well know, and so we believe the Uruguay round is a proper area to do that.

Number two, we have bilateral discussions in other areas such as apples, which as I will note when we came in it had only been going on for 13 years, that we are also addressing and we will not allow it to go on for 13 years, let me assure you of that. So we believe those are the more productive areas of approaching the agricultural problem rather than in this framework agreement. Frankly, it might have been confusing to put—as we go to Geneva to negotiate tariffication, the agricultural area which would affect those closed markets in Japan—to put that in the framework as well, that could have been played off, frankly, against each other which we didn't want to happen.

Mr. HOAGLAND. It seems to me there are a lot of specific sectors that are not specifically mentioned in the framework in the joint statement, but I am curious as to whether the sentence, the first sentence of the third paragraph under basic objectives, Japan will actively pursue the medium term objectives of promoting strong and sustainable domestic demand led growth, and increasing the market access of competitive foreign goods and services is not meant to include agriculture as well as a number of other things?

Ambassador KANTOR. Well, it could. Frankly, this is just the rules of the game. It is very broad. For instance there is one basket called "other sectors." Although it concentrates on auto and auto parts which is, as you know, two-thirds of our net trade deficit, it is fairly broad in its language, and so therefore we believe that, of course, can be used in many different areas.

Mr. HOAGLAND. Well, let me illustrate my concerns specifically. The Nebraska State Department of Economic Development has presented me with some figures in terms of Nebraska exports to Japan and other nations, and on one hand of the total $700 million in food and kindred products exported by Nebraska, Japan purchased $440 million, so that is quite favorable, well over 50 percent

of our exports in food and kindred products, yet agriculture production crop, we in Nebraska exported $65.5 million of products to the world and Japan purchased only a half a million, only about $500,000, so less than 1 percent of our crop exports went to Japan which clearly is out of line with the potential of the Japanese marketplace.

Now, Mr. Bergsten and Noland in their book indicate that in the agriculture sector, particularly Japan is noncompetitive as against the United States, that they say specifically the United States is highly competitive in agriculture and numerous service sectors where Japan lags substantially. I guess I would like to receive your assurances that the framework agreement includes agriculture and that your office will work very hard to open up the Japanese market to United States agricultural exports.

Ambassador KANTOR. We are doing a bilateral or multilateral basis. We are going to open that market up to agriculture. It is a critical sector not only to this country, it is $40 billion a year in known exports, about 10 percent, just barely less than 10 percent of our exports right now. Our farmers, of course, are the most competitive in the world. It is a market we want to open up, and it is one of our highest priorities.

Let me just indicate there are many other numbers we could use in addition to the agriculture numbers which indicate a closed market in Japan. One of the most stunning is that OECD nations, industrialized nations, average about, in their consumption of manufactured products, about 7.4 percent a year. In Japan that is 2.7 percent, less than a third of the averages of the other OECD nations. Of foreign direct investment stock in the world, about 28 percent is in the United States, about 33 or 34 percent is in Europe, by the way, seven-tenths of 1 percent in Japan. Whether it is services, whether it is industrial or manufactured products, whether it is agriculture, we face a real challenge in opening up the Japanese market. This is the second largest market in the world.

Let me just mention one other thing that is interesting, that is going to become more and more of, I think, of a talking point for all of us. The Japanese last year consumed about 14 million tons of steel to build their cars in Japan. Not one ounce was purchased from any foreign supplier. They purchased about 7 million tons of steel from the United States for other purposes. Only 1.7 million, though, was in the high value-added finished steel products.

When the second largest economy in the world literally closes its market to a particular product like steel, it is no wonder that we have dumping in the United States because it is only natural that countries then locked out of the Japanese market are going to turn to the largest market in the world, which is the United States. This is not the—it is just right on my mind today because of some things going on in our office, so all I would say to you is we have a challenge in many different areas and agriculture is one of the most important.

Mr. HOAGLAND. It is certainly one of the areas that would benefit the Japanese consumers, an issue you alluded to earlier, in addition to American producers considerably. It is really quite stunning, I think, when we examine the degree to which the Japanese market is shut off. Bergsten and Noland in their book indicate that

Japan is clearly different than the United States in four senses. First, a very low share of imports of manufactured goods in domestic consumption, certainly in relation to what our consumption of Japanese goods is, the very low share of intraindustry trade, the small share of foreign companies and domestic sales, and the very high share of trade conducted within Japanese companies. As you indicate, Mr. Kantor, with the tremendous potential of the Japanese market and with the extraordinary efficiency with which we can produce agricultural goods here, I would urge you to press as hard as you can on this particular front.

Ambassador KANTOR. We will. We appreciate that advice. You are absolutely correct, and it is of the highest concern to this office and this administration.

Mr. HOAGLAND. And again these figures of Nebraska's total crop exports of $65 million, only $500,000 should go Japan is quite striking. Thank you.

Ambassador KANTOR. Thank you.

Mr. HOAGLAND. Thank you, Mr. Chairman.

Chairman GIBBONS. Mr. Shaw.

Mr. SHAW. Thank you, Mr. Chairman. I will be somewhat brief. First of all, I want to comment and congratulate the administration on the progress that was made in the Tokyo summit. I do have concerns, however, that we left with only describing our relationship with Japan as looking for a qualitative and quantitative progress. Those, of course, can be weasel words, as we in the legal profession used to say, and they sort of defy any categorization. I do know that the administration sought to get some real numbers in setting some benchmarks that we could then go back and review to see whether we are, in fact, making progress. I do know that these negotiations are an ongoing process and also I can readily recognize the fact that you are indeed dealing with a caretaker government or a lame duck government and anything that is negotiated at this point has to be redone in the future.

Is it the administration's intention to come up with exact benchmarks in the future so that we can give the Japanese a report card on how we are progressing so that we can make some real progress in getting this trade deficit down?

Ambassador KANTOR. Exactly, Mr. Shaw. First of all, you will note a phrase in there called tangible progress. That is related to the quantitative and qualitative measures which are related then to the five baskets. We never intended for this framework agreement, so-called rules of the game, to have numbers in them because these are not the agreements themselves. These are just the outline of how we are going to proceed to reach agreement. We fully intend that the quantitative and qualitative measures which we will use to indicate success or lack of success being reached in any particular sector are going to be a vital part of the agreements that we negotiate in the future.

Mr. SHAW. I hope that we will stick to our guns on that, and when the new Government is in place in Japan that we will be very hard-nosed in our negotiations. The Japanese are excellent in agreeing to something that will have no more authority than a letter of intent, and, of course, I think that is what we have at this point which I certainly am not critical of, but I think that the devil

is in the detail and the detail is yet to come and I would hope that you really keep their nose to the stone on that because we just seem to be getting further and further behind in our dealing with the Japanese, and it is time that we turn it around. I think the point that you made about the cost of consumer goods is an important one. Because of their industrial nationalism, the Japanese are continuing to punish their own people, the consumers. This is somewhat outrageous when it is creating a big deficit here in this country. Obviously, the well-being of our economy, the well-being of our worker impacts directly upon the Japanese who depend very heavily upon our markets for their own economy.

If we were to suddenly cut off trade with the Japanese, obviously we would suffer here, there is no question about that, because of the huge debt we have, but their economy would be thrown into an absolute chaos, and I hope that we can remember that in negotiating with them that we don't intend to hurt each other, but we want to be vigilant and we want tangible results that can be measured with actual numbers which I think is vitally important to the future trade relationship with the Japanese Government.

Ambassador KANTOR. I agree, Mr. Shaw. We have the largest open market in the world. Twenty-eight percent of Japanese exports overall come to the United States. We are trying to open Japanese markets, not close ours, as I think you would agree. The second largest economy in the world has to be open to all foreign suppliers, not just U.S. suppliers, and that is what we are trying to do in these framework discussions, to pursue these discussions on an MFN basis, but we are committed to American workers and American businesses to expand our economy. In order to do so, trade is critical, and that means we have to deal with the second largest economy of the world, and you can be assured that we are focused like a laser beam on that subject.

Mr. SHAW. Like a laser beam?

Ambassador KANTOR. Like a laser beam.

Mr. SHAW. OK. Thank you, Mr. Chairman.

Chairman GIBBONS. Mr. McNulty.

Before we go on, let me ask, have you ever eaten a Japanese apple?

Ambassador KANTOR. You know, I think, yes, I have. In fact in my last two trips they were nice enough to have a basket of fruit in my room, which I think must have cost a fortune, but it had a Japanese apple. Yes, I have.

Chairman GIBBONS. Well, I just wanted to ask one of your two Ambassadors to smuggle you back one sometime when they are over there. They will have to smuggle it past our agricultural inspectors who will confiscate it.

Ambassador KANTOR. Since I adhere to all laws, I didn't try to do that, Mr. Chairman.

Chairman GIBBONS. All right. Well, I will bring one back for you. I just want to tell you just to kind of outline the difficulties you are up against, and I don't condone at all the Japanese closed market on our apples, but our apple is sort of an hors d'oeuvre. Their apple is a meal. Their apple costs you a fortune. It is handgrown and it is not an agricultural product, it is an art form. You go out into the orchards which will be about the size of this table up here,

and you will find little ladies running around raising apples, enclosing each apple in its own cocoon of garment to keep the birds and insects away from it. When the Japanese family sits down to have an apple, it is a meal, and that demonstrates the kind of differences that exist in our cultures and our agricultural practices. The apples are delicious, but the Japanese apple is not an agricultural product, but rather an art form. This is what you are up against when you negotiate with the Japanese not only on apples but on a lot of other things, but this is no excuse for Japan's closed practices. I commend you and wish you well in your negotiations with them on these issues.

Ambassador KANTOR. Mr. Chairman, I note the Speaker of this great body is from the State of Washington, and so is my wife, and I am not about to comment on your last comment.

Chairman GIBBONS. Mr. Dreier, who is our next witness, has asked if he could just ask you one brief question. He will take it out of his time before the committee.

Mr. DREIER. Thank you very much, Mr. Chairman. Let me just first say to you, Mr. Chairman, that I am going to be enjoying an art form for lunch in about an hour and a half.

Chairman GIBBONS. How did you get it in this country?

Mr. DREIER. We have some art forms here that are also grown in orchards.

Let me say that—congratulations to you, Ambassador Kantor, and your colleagues for moving in what I think is a very positive direction. I would just like to follow on the questions that were raised by Mr. Neal and Mr. Shaw.

Chairman GIBBONS. You haven't got that much time.

Mr. DREIER. I know. This is my one question, Mr. Chairman. Japan bashing is clearly a very popular thing domestically here in this country. Ambassador Mansfield has made a statement that if we are too tough with the Japanese we will be in a position where we are encouraging them to move in the direction of the Chinese and the Russians, and I wondered if you might comment on the challenge of trying to walk that fine line between the pressure that is here at home and the direction that we really want to move, and that is free trade.

Ambassador KANTOR. We have great respect for the Japanese people and what they have accomplished. I think all of us here do. There is a lot that they have accomplished industrially and otherwise we could emulate. Let me just say that I think tough is an overused word. I think practical, pragmatic, realistic and operating on behalf of American workers and American business is what we ought to be about. I don't want to bash anyone. I just want to open markets and expand trade and work with this President in order to make sure our economy begins to expand again, so that is what we are trying to do. We are not trying to bash anyone.

Mr. DREIER. Thank you very much. Thank you, Mr. Chairman.

Chairman GIBBONS. All right, fine. Thank you, Mr. Ambassador. Good luck.

Ambassador KANTOR. Thank you, Mr. Chairman.

Chairman GIBBONS. David, you are next.

Let me say to all members who weren't present when we made the first announcement, we have to be out of this room by 12:45

today. There will be another meeting in this room involving some of the same actors.

Before we go to Mr. Dreier, let me say that Mrs. Kennelly, who is a member of this subcommittee, could not be present this morning. She has a number of questions for the Ambassador, and we will send them to the ambassador and ask him to respond for the record. Without objection, those questions will be included at this point.

[Answers to Mrs. Kennelly's questions follow:]

U.S.-JAPAN TRADE RELATIONS HEARING
JULY 13, 1993
THE HONORABLE BARBARA B. KENNELLY

QUESTIONS FOR AMBASSADOR KANTOR:

Mr. Ambassador, the agreement on distilled spirits announced in Tokyo covers whiskey and brandy, but, at Japan's insistence, does not include white spirits, such as vodka, rum and gin, or cordials or liqueurs. Yet these products are important export items for U.S. producers. On a volume basis, they represented nearly 25 percent of total U.S. distilled spirits in 1992. What are your plans for ensuring that a zero-for-zero agreement covers all distilled spirits, including white spirits?

ANSWER:

The Tokyo agreement clearly states that it comprises only the minimum elements necessary to achieve an overall balanced package in the market access negotiations. Moreover, the agreement states that the Quad will seek to add zero/zero sectors to those identified in Tokyo. We shall continue to press vigorously in all sectors where we were not able to reach agreement in Tokyo. Clearly, white spirits is an area where we will seek agreement for zero/zero.

In addition, we just returned from two weeks in Geneva where we met with other countries both bilaterally, and multilaterally. It was clear from these discussions that many countries are dissatisfied with the limited coverage of the Tokyo agreement on distilled spirits and will be pressing the Japanese for further concessions in this area.

QUESTION:

I understand that your Japanese counterparts indicated in Tokyo that Japan is prepared to consider eliminating tariffs on certain white goods. When do you intend to renew your discussions with Japan on this key issue for the U.S. distilled spirits industry? Will you continue to press Japan to agreement to cover white spirits, including, vodka, cordials, liqueurs, in the zero-for-zero agreement?

ANSWER:

We have not stopped and will not stop our discussions with Japan on expanding their zero/zero coverage in distilled spirits to include white spirits. We will continue to press them bilaterally, plurilaterally, multilaterally, and in the Quad context.

Drafted by: BNorton x5097

Chairman GIBBONS. Our next witness is the Honorable David Dreier, a member of the Rules Committee and a Member of Congress from California. David, we will put your entire statement in the record together with your attachment, your article in the Policy Review, and you may proceed.

STATEMENT OF HON. DAVID DREIER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. DREIER. Mr. Chairman, I would also like to include the Wednesday Group study which deals with the issue of cost protectionism in Japan, if I could.

Chairman GIBBONS. All right, fine, we will put that in the record.

Mr. DREIER. Thank you very much. Mr. Chairman, let me say that having welcomed you all so many times before the Rules Committee, it is nice to be on this side of the table. I will be very brief because I know the time constraints here. The day before we adjourned for the Independence Day recess, Vice President Mondale, who has been nominated to become Ambassador to Japan, testified before our Joint Committee on the Organization of Congress, and it was difficult to decide which is going to be a more difficult challenge, trying to reform the Congress or diminishing Japan's trade barriers, so I decided that while he was testifying on the organization of Congress and legislative-executive relations that I would take advantage of that opportunity to talk trade.

At that point I urged Vice President Mondale to build upon the work of Ambassador Mansfield who in 1987 called for a United States-Japan free trade agreement as a means to depoliticize trade issues and improve the economic relationship between two of the world's largest economic superpowers. I was extremely encouraged by Mr. Mondale's receptiveness to such a strategy, and I believe that he is going to be a tremendous asset as we look at trying to pursue the goals which Ambassador Kantor just outlined here: I think that he is going to be committed to the goal of trying to make Ambassador Mansfield's vision a reality.

About half a decade ago, I was invited to meet with a Chevrolet dealer in southern California. He advocated that we impose a 100 percent tariff on Japanese automobiles coming into this country. As I walked out of that meeting I was struck with the fact that that would be an obvious mistake. It seemed to me then, and today, that the goals which Mickey Kantor has just spoken about are ones which we should be pursuing, trying to move in the direction of a free trade agreement.

Mr. Chairman, you and Mr. Crane and Mr. Matsui and others have discussed with me this issue of United States-Japan free trade. I know Mr. Crane has worked diligently on it, and you will recall that last year I made an attempt to defeat the previous question on the Miscellaneous Tariff Act of 1992 so that the House could consider an amendment in support of a United States-Japan Free Trade Agreement. What I basically want to do is expand on this framework agreement that we have just heard Ambassador Kantor describe and move in the direction of even freer trade with Japan. Our relationship with Japan is, I believe, at a critical juncture. We are only days away from that framework agreement which was signed, and Mickey Kantor deserves a great deal of

credit for coming to that agreement in Tokyo and for moving away from what has been of great concern to many of us for a long period of time—this rhetoric of managed trade and retaliation. Instead, the administration is beginning to focus on opening up the Japanese market, using the principles of free trade and more economic integration.

Should the eventual negotiations move toward the achievement of a free trade agreement between our two nations, then this framework agreement clearly will have been the greatest achievement of the summit. Therefore, I hope that Mr. Kantor will carry the message to the President that there is clear, bipartisan support here in this Congress, not just among members of this subcommittee, but in the entire Congress, to begin to proceed with even further negotiations in the area of free trade. There is no need, Mr. Chairman, for partisanship when we deal with trade because our whole economic future depends on a dynamic and growing export sector.

I have consistently applauded President Clinton when he has advocated policies that I believe will benefit our country. As Mr. Matsui knows, I have been a strong proponent of NAFTA. I have congratulated the President consistently on that, and worked closely with Mickey Kantor on it, and I will say this: as long as Ambassador Kantor continues to pursue a trade policy with Japan that is based on this concept of free trade and expanded export opportunities for the United States, I will continue to be very supportive there also.

Mr. Chairman, I think that as you look at this issue of managed trade, we should stop trying to make America look more like Japan. Managed trade and specific bilateral business-Government agreements play right into Japan's hands. Americans can compete, as we have found, and they do their best in the most open and free economy. It makes more sense to create an environment where American business can outcompete their Japanese counterparts rather than try to have our bureaucrats and politicians outmanage Japan. The results from Tokyo provide evidence that critics of free trade with Japan are wrong. The political environment in Japan is changing, as we have discussed here today, but one thing appears very obvious—the political turmoil there is caused in part by what I believe to be a rigid anticonsumer, Japanese economic system, and that was raised here with Mr. Kantor. This provides a tremendous opportunity for free trade because the Japanese consumer is, I believe, our greatest ally in the process. Now, there are some people who have argued that Japan's rather austere lifestyle does not create the kind of demand for U.S. goods that is out there. I do not believe that the Japanese people have been given that option due to protectionist barriers.

Just as there is a split in Congress on trade policy, there also appears to be one in the administration. The results from Tokyo appear to be both a compromise between the American and Japanese negotiators and a compromise among the factions in the Clinton administration.

Faced with the possibility of an American Government committed to state-managed trade, the Japanese Government now appears

committed to more free trade. I hope that the deadlock in the administration will likewise break toward the direction of free trade.

For those who may be gun shy over free trade because of the controversies surrounding the North American Free Trade Agreement, I would point out that Japan has capital, labor, and environmental conditions which are strikingly similar to ours. As a result, free trade would not be subject to the same kinds of criticisms that have been leveled toward NAFTA.

The coming trade negotiations, if based squarely on free trade principles, provide the best opportunity to ignite a powerful engine of growth in both countries and would be one of the most remarkable accomplishments of the 20th century.

Mr. Chairman, I thank you very much for the opportunity to testify here. I thank you and members of this subcommittee again for the support that you have provided us for moving in the direction of a United States-Japan Free Trade Agreement, and I hope very much that it will, as we begin with this bilateral relationship that we will be able to expand it to a multilateral agreement which will clearly benefit both workers and consumers worldwide.

[The prepared statement and Wednesday Group study follow:]

Statement of the
Honorable David Dreier

before the

Subcommittee on Trade
Committee on Ways and Means

July 13, 1993

Mr. Chairman, Members of the Committee, thank you for holding this important hearing on trade, commercial, and economic relations between the United States and Japan, and for allowing me to make a brief presentation.

On July 1, Vice President Walter Mondale, who was nominated by President Clinton to be our next Ambassador to Japan, appeared before the Joint Committee on the Organization of Congress to talk about Congress-Executive Branch relations. I could not decide which is a more challenging undertaking: correcting the trade imbalance with Japan or creating a congressional reform package that can pass Congress. So I decided to take advantage of the opportunity to talk trade.

I urged Vice President Mondale to build upon the work of his predecessor, Mike Mansfield, who, as Ambassador to Japan, called for a U.S.-Japan free trade agreement as a means to depoliticize trade issues and improve the economic relationship between two of the world's largest economic superpowers. I was extremely encouraged by his receptiveness to such a trade strategy, and I believe Mr. Mondale will be a tremendous asset to the Administration and to those of us who want to make Ambassador Mansfield's vision a reality.

As you know, Mr. Chairman, I have not only been an advocate of free trade negotiations with Japan, but have sponsored legislation calling on the Administration to undertake a framework agreement with the Government of Japan under which to initiate negotiations for a free trade agreement. Also, whenever I have had the pleasure of discussing these issues with you and Mr. Crane, I have been greatly encouraged by your commitments to the principles of free trade, and want to thank the both of you for your leadership on this issue.

Our trade relationship with Japan is at a critical juncture. We are only days removed from the signing of a potentially historical trade Framework Agreement between the United States and Japan. Ambassador Kantor deserves credit for coming to an agreement in Tokyo that begins to get away from the rhetoric of managed trade and retaliation, and instead starts to focus on opening the Japanese market using the principles of free trade and more open economic integration.

Should the eventual negotiations move toward the achievement of a free trade agreement between our two nations, then this Framework Agreement may prove to be the most important achievement of the summit. Therefore, after this hearing, I hope that Ambassador Kantor will take a message to the President that there is support in Congress for a strong negotiating strategy based on free trade.

Mr. Chairman, there is no need for partisanship when we deal with trade, because our whole economic future depends on a dynamic and growing export sector. I have consistently applauded the President when he has advocated policies that I believe will benefit our country. For example, I have been a vocal supporter of the President's strong stand in support of NAFTA. As long as the President pursues a trade policy with Japan based on free trade and economic expansion, I will be equally supportive.

In short, Mr. Chairman, we should stop trying to make America more like Japan. Managed trade and specific bilateral business-government agreements plays right into Japan's hands. Americans can compete, and they do their best in the most open, free economy. It makes more sense to create an environment where American business can out-compete their Japanese counterparts, rather than try to have our bureaucrats and politicians out-manage Japan.

The results from Tokyo provide evidence that critics of free trade with Japan are wrong. The political environment in Japan is changing. It may be an earthquake, or it may be just a large tremor. But one thing appears obvious: the political turmoil there is caused in part by the rigid anti-consumer Japanese economic system. This provides a tremendous opportunity for free trade, because the Japanese consumer is our greatest ally in this process.

Just as there is a split in Congress on trade policy, there also appears to be one in the Administration. The results from Tokyo appear to be both a compromise between the American and Japanese negotiators, and a compromise among the factions in the Clinton Administration. Faced with the possibility of an American Government committed to state-managed trade, the Japanese Government now appears committed to more free trade. Hopefully the deadlock in the Administration will likewise break toward the direction of free trade.

For those who may be gun shy over free trade because of the controversies surrounding NAFTA, I would point out that Japan has capital, labor, and environmental conditions strikingly similar to ours. As a result, free trade would not be subject to the same criticisms that NAFTA has faced.

The coming trade negotiations, if based squarely on free trade principles, provide the best opportunity to ignite a powerful engine of growth in both countries, and would be one of the most remarkable accomplishments of any 20th Century president. I have attached to my prepared statement an article that I wrote for Policy Review which elaborates on the benefits and tribulations of free trade negotiations. I also ask permission to submit for the record a study by the House Wednesday Group which describes the conditions resulting in cost protectionism in the Japanese market.

Open Sashimi

The Case for Free Trade with Japan

David Dreier

The time is ripe for constructive engagement between the United States and Japan. Forty years of antagonistic trade relations have failed to resolve our differences, which now threaten to erupt into a full-scale trade war. Trade deficits, "dumping", charges of unfair competition, and our own sluggish economy have many in Congress ready to clamp down on Japan with harsh, punitive trade measures.

In 1992 the House passed a number of anti-Japan bills, including the so-called Trade Expansion Act, which would mandate punitive measures against "unfair" trading countries and single out rice and auto parts for such action. In addition, the House passed the Miscellaneous Tariffs Act, which would arbitrarily increase the tariff on Japanese minivans from 2.5 percent to 25 percent, despite the fact that U.S. manufacturers command over 88 percent of the U.S. minivan market. Fortunately, the threat of presidential vetoes stalled Senate action. But now that President Clinton is settled into the White House, it is likely that the House and Senate will take these measures up again this year.

Meanwhile, Japan has just announced its highest-ever trade surplus with the United States—$44 billion in 1992. Even though this surplus rose because of a slowdown in Japan's own economy, the announcement is sure to fan protectionist flames in the U.S. Congress.

Instead of hiding behind the high walls of protectionism and fear, we should focus on lowering Japan's trade barriers so that American companies can compete more freely. The best way to achieve this objective is to negotiate a comprehensive free-trade agreement with Japan.

NAFTA's New Ball Game

This idea is not new. In 1987, then-U.S. Ambassador to Japan Mike Mansfield called for a free-trade agreement with Japan, suggesting that "The U.S. should switch from approaches which politicize trade issues, exacerbate friction, raise emotional stakes, erode public support here for American objectives, and risk undermining both countries' commitment to the alliance." The *New York Times* called his proposal "an idea searching for its time to come." Critics, however, said that the Japanese had no reason to cooperate, and would agree to trade liberalization only in principle, not in practice.

Global trade dynamics will change dramatically, however, if Congress approves the North American Free Trade Agreement (NAFTA). With the advent of regional trading blocs like NAFTA and the European Community, the Japanese are worried that they will be edged out of world markets. NAFTA would not only make U.S. products more competitive, it would also exclude many Japanese products with tough rules of origin and other agreements that favor products from North America. To preserve its access to its most important export market, Japan would have a strong incentive to negotiate a comprehensive trade agreement with the United States and to implement it in good faith.

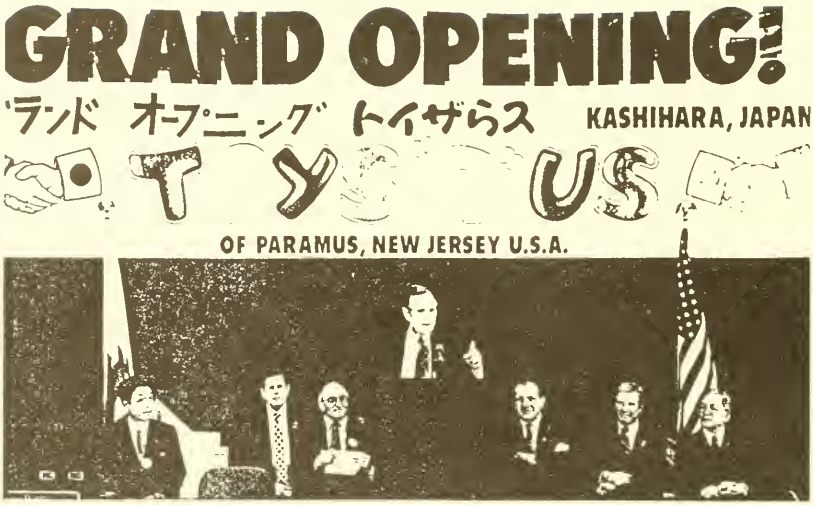
Benefits to U.S. Exporters

American industries also have strong incentives to support a free-trade agreement with Japan. Many American industries stand to make significant gains from increased market access in Japan. Agriculture, textile, lumber, paper, printing and publishing, coal, transportation, and telecommunications industries, among others, would benefit greatly by lifting the artificial barriers that block their entry into the Japanese market.

For example, Japan is already the largest export market for U.S. agricultural and forest products, with combined sales of $10.3 billion in 1991. There is vast potential to increase these numbers in an open market. Japan is the largest international purchaser of forest products from Washington and Oregon. According to industry experts, these states will benefit even more as Japan starts building more western-style houses, and as the forest products industry begins to cater more to Japanese consumer needs. Even pre-fabricated log cabins from the United States are beginning to catch on in Japan!

American farmers also will reap the benefits if Japan

David Dreier, *a congressman from California, is the ranking Republican member on the Subcommittee on Rules of the House, which has jurisdiction over expedited trade legislation.*



Reuters/Bettmann

A free-trade agreement would make it easier for U.S. retailers to open stores and sell American products in Japan.

lifts its import restrictions on certain agricultural products, including rice, vegetables, eggs, chicken, pork, milk, and other dairy products. Japan currently imports over 50 percent of its food products, and American farmers could secure an even larger share of the Japanese market if import restrictions and high tariffs were eliminated.

At a time when American industries are suffering from an anemic economy, they would secure big dividends by increasing exports to Japan. The alternative approach to a free-trade agreement—imposing retaliatory measures on Japan—would do nothing to increase exports, but rather would risk closing the door to trade with Japan altogether.

Bipartisan Congressional Support

President Clinton stands at a crossroads on trade issues. Given his support for the principles of free trade during the campaign, Mr. Clinton could solve many of our nation's economic problems by breaking down the barriers to American exports. Or, he could succumb to the immense pressure of his party's dominant special interests, which have an aversion to free trade and open markets. Our new president has given lukewarm support to NAFTA. However, Mr. Clinton should be receptive to the idea of proposing a free-trade agreement with Japan, especially since such an agreement would entail none of his NAFTA-related concerns about the environment or competition from low-wage labor. Japan's environmental regulations are as tough as or tougher than those in the United States, while wage and benefit levels are comparable to the leading industrial nations.

In addition, President Clinton would find bipartisan congressional support for a U.S.–Japan free-trade agreement. Since Ambassador Mansfield's call for free trade, several members of Congress, including Sam Gibbons, Phil Crane, Jim Kolbe, and I have supported legislation to begin free-trade negotiations. Others have spoken in favor of a free-trade agreement with Japan, including Jim Traficant and Doug Applegate, both Ohio Democrats who take a tough line on trade with Japan.

Congressman Traficant said that while he objects to free trade with Mexico, he "would advise Congress to ... look to a free-trade agreement with Japan." Applegate said that a free-trade agreement with Japan would "open up the Japanese ports of entry to American productivity ... [and] eliminate discriminatory practices which the Japanese practice against U.S. products." In addition, there are many other free-traders in Congress who would support such a proposal given a strong show of leadership from the president.

Enormous Market to Tap

A free-trade agreement would give the United States access to a largely untapped market of over 124 million Japanese consumers. Despite having the second-largest market economy in the world, Japanese private consumption ranks near the bottom in the industrialized world. In fact, according to a 1991 Organization for Economic Cooperation and Development (OECD) survey, Japan spends only 8 percent of its total gross national product on imports, far below the 19 percent average among major OECD countries. For years, the Japanese have artificially suppressed their market with stringent restric-

Both photos: Photofest

America and Japan are headed toward a trade war that would not serve the interests of either economy.

tions on imports. The resulting high prices have hurt Japanese consumers and dampened demand for imported products. These import restrictions would be a prime target of a U.S.–Japan free-trade agreement.

For example, Japan's Food and Control Act was created during a period of wartime scarcity and continues to monopolize all aspects of agricultural production, marketing, and trade. Japan's Food Agency buys imported products at market prices and then resells them at much higher domestic prices. Lifting these controls would be a boon for American agricultural exporters, not to mention Japanese consumers, who pay notoriously high prices for their food.

Such a change would also benefit an important constituency for Bill Clinton: Arkansas rice farmers. Japan maintains an almost total prohibition on rice imports, and Japanese rice farmers receive extremely high price supports from the government. If the Japanese rice market were liberalized, U.S. industry experts estimate that U.S. rice exports could increase to as much as $650 million a year. There also is evidence that public opinion in Japan is more open to rice liberalization than one might assume. A 1990 survey in a Japanese business newspaper indicated that 70 percent of the Japanese public favored opening their rice market to imports.

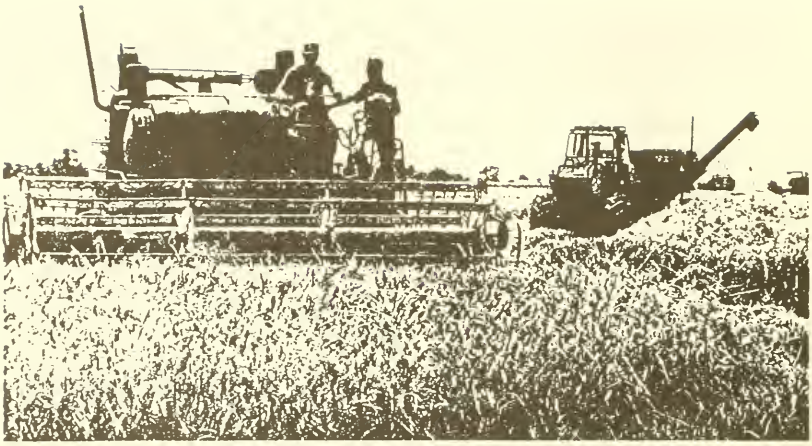
Japan's environmental regulations are as tough or tougher than those in the United States.

Tyranny of the Status Quo

Opponents argue that free trade will not increase market access for the United States since, on paper at least, Japan already has some of the lowest trade barriers in the world. Indeed, a U.S.–Japan free-trade agreement should be unlike most traditional trade agreements, which focus primarily on tariff reductions. Japan now has the lowest tariff level of all the OECD countries—Japan's average tariff rate on industrial products is only 2 percent.

However, high tariffs remain on many products important to U.S. producers, including petrochemical products, aluminum products, paper, and agricultural products. In addition, Japanese import quotas continue to limit American agricultural products, including wheat, rice, barley, and peanuts. U.S. leather products and footwear also continue to face substantial barriers, despite Japanese efforts to modify their import quotas and restrictions. Established exporters tend to receive the lion's share of import quotas, making it extremely difficult for American companies to obtain import quota shares on new products. Import quotas and remaining tariffs are significant barriers that would be lifted under a free-trade agreement.

Others argue that a free-trade agreement is unnecessary given the presence of the General Agreement on Tariffs and Trade (GATT) and the Structural Impediments Initiative (SII). A free-trade agreement with Japan would not override these agreements, but would contribute to the overall goal of liberalizing world trade and opening markets to U.S. products. Unlike GATT, a free-trade agreement would address specific concerns that the United States has with Japan, and our unique relationship with that country. A free-trade agreement would address Japan's opaque and informal decision-making process, labyrinthine distribution system, regulatory requirements, patent infringement, and lax



AP/Wide World

American farmers, such as these rice growers in Texas, would benefit enormously from a lifting of Japanese import restrictions.

antitrust enforcement, all barriers to U.S. exports.

Free-trade negotiations also can give higher public visibility to non-tariff barriers to trade. Unlike the SII, which has become mired in technical details, such as how much public investment and how many sidewalks Japan should have, a free-trade agreement offers a more comprehensive format that would attract more attention from the general public. As a result, both countries would feel more pressure from the public to negotiate a successful agreement, and both countries would have the opportunity to resolve their most pressing trade problems. Otherwise, the United States is left with only punitive action, which will not further our interests.

Are Keiretsu a Barrier?

Some opponents argue that cultural differences are insurmountable barriers to free trade with Japan. There is no doubt that cultural and language differences make it more difficult for U.S. companies to do business in Japan. However, cultural barriers to trade are not insurmountable. For example, *keiretsu* arrangements, consisting of interlocking industrial, financial, and trading companies, exclude outsiders and stifle competition. *Keiretsu* have often been cited as one of the impenetrable cultural barriers to U.S. investment and trade in Japan.

A recent survey of senior executives of U.S. companies in Japan was conducted by the A.T. Kearney Company for the American Chamber of Commerce in Japan (ACCJ). It found that, while 47 percent said that *keiretsu* restricted their ability to do business in Japan, 32 percent said that *keiretsu* had a positive effect on their business with Japan. With a little hard work, American businesses can break into these closed relationships. IBM, Coca-Cola, Amway, Hewlett-Packard, and dozens of other American companies have succeeded in Japan, despite the many cultural barriers blocking their path. A free-trade agreement would require Japan to hold *keiretsu* members accountable for anti-competitive activities that violate Japan's antitrust laws. Japan has been under fire for years for not enforcing its antitrust laws, and this would be a major focus of a free-trade agreement.

There also are many tangible, non-cultural barriers that can be identified and addressed successfully in a free-trade format. For example, a free-trade agreement would focus on the many building restrictions in Japan that keep new businesses from entering the market in major cities like Tokyo. The ACCJ-Kearney study found that 55 percent of American businesses in Japan said that the high cost of doing business in Japan is the greatest impediment to market access. Only 22 percent cited non-tariff barriers such as *keiretsu*. The high price of land is by far the biggest factor increasing costs to new businesses. Although land costs have peaked since their height in the late 1980s, the average cost of land in Japan is still the highest among OECD countries. A recent survey cited in an upcoming House Wednesday Group report found that the average cost for a square meter of land in downtown Tokyo is $6,000, while a comparable plot of land in Los Angeles costs an average of $108.

Restrictions on Retailers

While the continuing depreciation of the dollar contributes to the high cost of land for Americans, Japanese government restrictions are a major factor. The Japanese government encourages individuals to hold on to their land with low property taxes and relatively high capital

AP/Wide World

Whatever the cultural differences between the two countries, Japanese consumers love American goods and services.

gains taxes on the sale of land. In addition, with virtually no property taxes on farmland and high agricultural subsidies, many gentleman farmers prefer to keep their land instead of selling it for development.

The Japanese government's taxation and zoning policies have stunted the growth of business in Japan. The average building height in Tokyo is only 2.7 stories tall, much lower than in most of the world's metropolitan areas. Earthquakes are not the reason for the lack of tall buildings—tall buildings frequently offer more structural support than small buildings during an earthquake. Rather, local "sunshine laws" and other zoning restrictions limit the height of buildings. A free-trade agreement could work to remove these restrictions so that American firms have room to set up business in Japan.

The "think-small" mentality in Japan also affects the distribution system, which needs a major overhaul. Japan's Large Scale Retail Store Law has restricted the establishment of large retail stores in favor of small mom-and-pop stores that are limited in their selection of goods. In order to set up a large retail store, or to expand the floor space of existing stores, owners must obtain approval from a local council. Small store owners on the council often impede competition by blocking large stores from moving into the area.

Large American stores, such as Toys "R" U's, have had considerable difficulty setting up shop in Japan. Japan recently shortened the large-store application process to no more than one year, a considerable improvement considering that many applications were stalled for 10 years or more. After much effort, Toys "R" U's finally opened its doors outside Tokyo, and plans to open more stores across Japan. A free-trade agreement could reduce the waiting time for large store applications even more, and pursue any additional steps necessary to make large retail stores more accessible. If allowed into Japan, U.S. retailers would stock many U.S.-made products that they stock in their stores at home.

Two-Way Street

Free-trade negotiations should also focus on the many unwritten rules that shape Japan's trading system. They include: unnecessary testing standards, licensing procedures, and certification requirements; restrictions on direct foreign investment; and government subsidies to industries that give Japanese products an unfair advantage. Japan's trade bureaucracy operates largely behind closed doors, and procedures and standards are seldom publicized. This leads to an informal rule-making process, which often gives Japanese bureaucrats enormous control over whether to allow an American product into the country. These are all complex issues that will not be solved overnight, but in the context of a free-trade negotiations, significant progress can be made.

Critics also argue that a free-trade agreement with Japan would be entirely one-sided, because the United States has nothing to concede. Yet, despite our liberal investment laws and relatively open market, the United States maintains a number of protectionist policies that impede free trade. America does not have an unfettered market by any means. Areas of concern for the Japanese include U.S. dumping laws, "voluntary" restraint agreements, agriculture subsidies, arcane and duplicative banking regulations, import quotas and tariffs, punitive trade measures, and the number of government agencies with overlapping jurisdiction over trade negotiations.

A free-trade agreement undoubtedly would require the United States to reduce tariffs on Japanese products significantly, or perhaps eliminate them altogether. During recent GATT negotiations, the United States agreed to reduce its current 5.5 average tariff on mining and industrial items to 3.5 percent. However, U.S. tariffs on a number of items remain extremely high, including wool fabric (42 percent maximum), footwear (48 percent maximum), and glassware (38 percent maximum).

Also of significant concern for the Japanese are U.S. anti-dumping measures, which place the burden of proof on the accused corporation and ensure that once in place, dumping orders are virtually impossible to eliminate. There is no "sunset clause" for dumping orders. Congress originally required that the Department of Commerce review each dumping order annually, but this requirement was later repealed. Some dumping orders have been in place for a decade or more. A large proportion of dumping cases were determined on a "best information available" basis. If the accused firm does not respond in time to the charge of dumping, the information provided by the petitioner is usually used. This happens all too frequently when language barriers get in the way, or when a foreign firm does not wish to make

its trade secrets public. Anti-dumping laws apply arbitrary standards in determining the "fair" price for a product, and often fail to consider fluctuations in exchange rates, differences in American and foreign products, or the impact dumping orders will have on consumers.

New Ways to Handle Disputes

One of the U.S. trade policies most objectionable to the Japanese is Section 301 action authorized by the Trade Act of 1974. Section 301 allows the U.S. Trade Representative (USTR) to determine whether to pursue action against foreign governments that practice "unfair" trade. The USTR may increase duties or other restrictions on imports of goods and services from the offending country. The Japanese believe that Section 301 action violates the General Agreement on Tariffs and Trade (GATT), which prohibits unilateral retaliation against unfair trade.

The Trade Expansion Act, passed by the House in 1992, would have reauthorized the expired provisions of "Super" 301 action. But the bill would have gone a step further than Section 301 by requiring the USTR to develop a hit list of unfair traders and pursue harsh, retaliatory measures, including steep tariff hikes on imports from those countries. Measures such as this only serve to increase tensions between the two countries, and should be used only as a last resort. With a free-trade agreement, such action would be unnecessary because all disputes would be handled under the aegis of the trade agreement, or through an agreed-upon dispute resolution mechanism.

Voluntary Restraint Agreements (VRAs) are another barrier to trade that the Japanese would like to eliminate. VRAs currently restrict exports of Japanese passenger cars to 1.65 million a year. In addition, Japan placed VRAs on machine tools and steel after much insistence by the United States. Big-Three automakers and union officials have already met with President Clinton and Vice President Al Gore to urge them to lower the "voluntary" quotas for autos even further. Like other protectionist measures, VRAs distort the market and increase costs for consumers in order to prop up weak and inefficient industries. These industries become weaker as a result, and demand even more government protection, spawning a vicious and unproductive cycle.

Forging a bipartisan consensus for free trade with Japan would be one of the most remarkable accomplishments of any 20th-century president. A free-trade agreement would provide a format to negotiate a comprehensive solution to our trade disputes with Japan, and it would create jobs for Americans. As the engine of modern economic growth, exports are crucial to creating jobs and improving the economy. A free-trade agreement with Japan would also fit in well with Mr. Clinton's campaign theme, "It's the economy, stupid!" Let's hope that Mr. Clinton listens to that clarion call.

THE HOUSE WEDNESDAY GROUP
CONGRESS OF THE UNITED STATES

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BEYOND REVISIONISM:

Towards a New US-Japan Policy for the Post-Cold War Era

March, 1993

A PAPER FROM THE WEDNESDAY GROUP SERIES ON US-JAPAN RELATIONS

EXECUTIVE SUMMARY

In *Beyond Revisionism,* we present a new framework for assessing US-Japan relations and outline a trade strategy that, if implemented, could dramatically improve prospects for American business in Japan. Our findings and policy recommendations are based on over two and a half years of research on American companies operating in Japan. Under the supervision of the non-partisan Congressional Research Service, in 1991-92 we formally surveyed over 280 large American firms with Japanese operations. Furthermore, we did extensive background research, using Japanese as well as English language materials, and conducted a multitude of interviews with businessmen and government officials in America and Japan. Our goal was to understand what prevents so many internationally competitive American companies from penetrating the Japanese market to the extent they have elsewhere. Particularly, we wished to test the so-called "revisionist explanation" of the Japanese economic system that has gained a great deal of support in academia, industry and government over the last few years.

Proponents of revisionism assert that, in contrast to the open-market capitalism of the US and other Western nations, the Japanese practice "insider capitalism" in which the "visible hands" of personal-relationships between business executives and government officials determine who wins or loses, not the invisible hand of the free market. In order to succeed in Japan, a company has to be an insider. However, as the revisionists tell it, foreigners are systematically barred from gaining such status. Thus, even in the face of apparent market liberalization, the Japanese can fall back on their unique system of collusive relationships (embodied most obviously by the *keiretsu* corporate groups) to exclude foreigners. The net effect is a radical imbalance in economic relations between the US and Japan. Although Japanese companies receive free trade access in the US, American firms are covertly prevented from getting their fair share of the lucrative Japanese domestic market. To remedy the perceived situation, revisionists propose that the US government "contain" the activities of Japanese companies in the US and "strategically manage" American industry into succeeding in Japan by creating overarching market share agreements.

OUR RESEARCH FINDINGS

The Revisionists are Right: Japanese Capitalism is Different:

- Our research indicates that the Japanese capitalist system differs significantly from that of the US and most other OECD nations -- ideologically, structurally and behaviorally. The insider relationships -- between companies within industry and between industry and the government -- that characterize the system can make it very difficult for "outsider" firms to succeed, even if these outsiders are Japanese. In this regard, over 77% of executives surveyed by the Wednesday Group

identified culture as "more of a barrier to competing successfully in Japan than in other advanced industrialized nations."

The Revisionists are Wrong: Foreign Firms Can "Deal with Difference:"

- Contrary to revisionist thinking, "insider capitalism" is a game that non-Japanese can and do play. Over 30% of the companies surveyed by the Wednesday Group do what the "conventional wisdom" says is impossible -- they actively and successfully operate in Japan as insiders. For example: they lobby and influence the Japanese government on policy-making and implementation; they routinely exchange information with the bureaucracy on business developments; they participate actively in Japanese trade associations; and they build long-term supplier relationships and strategic alliances with their *keiretsu*-affiliated competitors.

- Nevertheless, many other American and other foreign corporations continue to do poorly in Japan or have chosen simply to stay away from the market. We find that to some degree this lack of success is due to their failure to face up to the exigencies of the business environment. For example, far too many US companies in Japan have little or no contact with the business and political establishments. This hampers their efforts to position their products effectively within the marketplace.

Extraordinarily High Costs Hold Back Foreign Business in Japan:

- For a foreign company to address the Japanese "insider network," it must maintain a large operational platform in Japan. A distant arms-length approach to trading rarely suffices in the arm-in-arm Japanese economic system. However, even for the largest, most financially endowed American companies, extremely high costs make the investments needed to establish and maintain import facilitating infrastructure in Japan very hard to rationalize.

- Rapidly escalating costs -- magnified by the marked increase in the valuation of the Yen versus the dollar -- have obviated many of the expected benefits that liberalization in the 1980s was supposed to provide for American companies operating in Japan. In a 1991 American Chamber of Commerce in Japan (ACCJ) survey of the environment for trade and investment, 65% of executives identified the high cost of fixed and operational investment as the greatest impediment to market access in Japan. OECD statistics similarly show that in almost all regards, Japan is the most expensive country in which a foreign company can do business.

- While costs increased in other major US markets in the 1980s, American companies have long been able to invest freely in these markets and could therefore develop their operations when the dollar was strong and local costs

relatively cheap. In Japan, a mix of high tariffs, overt capital controls, bureaucratic interference and cross-shareholding among companies made foreign investment extremely difficult -- if not impossible -- for most companies until the early 1980s. Then in the middle of the decade, when liberalization finally began to take effect, the costs of investment in Japan "went through the roof." This was the age of the so called "bubble economy." Ironically, the bubble served to protect the home market from foreign infiltration almost as effectively as the previous regime of formal protectionism.

- -- The costs of real estate investment in Japan tripled in the 1980s. By 1989, the total value of land in Japan exceeded the net worth of the United States by 4.5 times, despite Japan being only 1/20th as large as the US!

- -- The Nikkei stock market index more than tripled between 1985 and 1989.

- Because of high costs and a long history of formal protectionism, Japan has the lowest level of per capita foreign direct investment and foreign corporate participation in the industrialized world, despite having the world's second largest economy.

  - -- A few statistics illustrate the impact of high costs in Japan on normal corporate investment behavior. Direct investment by foreign interests (FDI) in Japan as of 1991 (the most recent complete statistics) was by far the lowest among OECD nations: $97 per capita -- by comparison, Germany has almost $1700 of FDI per capita; the US over $1600; and England, more than $4,000. Moreover, given the exaggerated costs of doing business in Japan, $97 represents even less than it appears. Foreigners control less than 1% of corporate assets in Japan and foreign affiliated companies account for only 1.2% of all sales in the economy.

The Japanese Practice De Facto "Cost Protectionism:"

- Even though the "bubble economy" has burst, Japan remains an extraordinarily expensive nation in which to invest, operate or live. Today, a "bubble within the bubble" continues to keep foreign investment and trade minimal. The main reason that costs remain so high is that the Japanese government continues to regulate land and financial markets in a pervasive manner. Until these policies are changed, we believe that we are justified in our concerns that Japan practices "cost protectionism."

  - -- Regulation in property markets is so extreme that despite being in scarce supply, land in Japan's urban areas is amazingly under-utilized. In fact, the average height of buildings in Tokyo is less than three stories tall.

The Japanese Trade Surplus and Cost Protectionism:

- Japan's massive trade surplus is also connected to its cost protectionist policies. Because of the artificially created shortage of available affordable property, the Japanese save money at an extraordinary rate. (We argue that it is much less the "spirit of frugality" than the lack of affordable opportunities to buy a new or improve an existing house that accounts for the Japanese penchant to save.) A high aggregate savings rate, as economists explain, detracts from overall consumption and increases the capital available for investment. Both of these factors help to explain the size and persistence of Japan's export surplus with the world.

  -- If the Japanese were to save less, they would consume more; consequently, there would be a greater demand for imports (which are more demand-elastic than domestically-produced products).

  -- Also, if the potential existed in Japan to invest rationally in real estate development, capital currently being put into expanding export-oriented plant and equipment capacity -- already in obvious excess -- could be employed to develop Japan's scarce land resources.

  -- The effects of ending cost protectionism would be multifarious -- benefitting the Japanese consumer and foreign producers, as well as Japan's image in the world as a "fair-trading nation."

Business Will Determine the Future of the US-Japan Relationship:

- We conclude that the future of the US-Japan relationship is largely dependent on the future of American business in Japan. The Cold War is over and long-neglected economic issues have come to the fore.

  -- The low level of direct participation by US firms in the Japanese economy not only increases the difficulty of balancing the economic relationship, but also threatens to diminish the faith that Americans have in Japan as a partner in constructing a new world order. People will ask why internationally competitive US companies cannot enter and thrive in the Japanese market, no matter how hard they try.

  -- Ultimately, the failure of American companies to become a vital part of the Japanese industrial system (as Japanese companies are in the US) strengthens the case of groups in the US which seek to contain Japan as both an egregious offender of the principles of free trade and a threat to US competitiveness.

-- The Japanese have a saying: "The nail that sticks up gets hammered down." The Japanese government and people must realize that due to their pattern of unbalanced trade and investment, Japan today appears internationally like a protruding nail.

Toward a Post-Revisionist US-Japan Policy:

Although we believe that a new US-Japan policy is needed, we soundly reject the trade policy proposals put forward by the revisionists. The US does not have to -- indeed, could hardly manage to -- curtail the presence of Japanese products in its markets. Moreover, the US does not require the further intrusion of federal government in the domestic economy in order to make American companies more competitive. Rather, the US must increase pressure on Japan to repeal policies which -- directly or indirectly -- continue to inhibit competitive non-Japanese companies from setting up full-scale operations in Japan, and which thus prevent those companies from gaining the opportunity to become full-fledged participants in the economy.

Constructive Engagement not Containment:

We believe that pressure must be applied in a positive, rather than negative, manner. What the US needs to adopt today is an aggressive policy built on the concept of constructive engagement, not containment. Building new bridges -- not burning old or existing ones -- will be the key to our future relations. Only by doing so will we be able to further the balanced integration of our two economies. Real bi-lateral economic interdependence must be attained if we hope to minimize the friction hampering our cooperation in dealing with the problems confronting us. It is very unfortunate that at a time when we need each other more than ever, we seem to be slowly moving apart. To quote an old Chinese proverb, America and Japan -- like a couple in the midst of a marriage crisis -- are "sleeping in the same bed, but seeing different dreams" (*doshou imu*). The threat is that America and Japan could become like a de facto divorced couple living in the same house, still theoretically allied but no longer very good friends.

US TRADE POLICY PROPOSALS

In response to the problems identified in this paper, the Members of the Wednesday Group will further consider the following proposals:

MACRO-LEVEL PROPOSALS:

- Pursue a new trade initiative with the transcendent goal of pushing Japan to abandon its regime of cost protectionist policies in order to finally create equal access for foreigners to the Japanese market;

- The insider network structure of business relations in Japan need not change, but for the sake of both foreigners and Japanese, the economy's cost structure must be made rational.

- As an interim measure while working to level the playing field for investment into Japan, the Japanese government might be called upon to offer significant "bridge incentives" to minimize the excessive cost of new investment. The government has initiated a number of programs to facilitate direct investment in Japan, but they remain insignificant when compared to some of the incentive programs offered by American states to lure Japanese investment.

- Reinvigorate the Market-Oriented, Sector-Specific (MOSS) approach to eliminate remaining sectoral non-tariff barriers opening to the Japanese market.

MICRO-LEVEL PROPOSALS:

- Appropriate funds to construct a *US Trade Development Center* in Tokyo (located on the grounds of the US Embassy) to house the offices of industry associations, state governments, and the Foreign Commercial Service. This facility could increase the ability of the US government and industry to promote trade and monitor industry developments in Japan;

- Expand government efforts to enhance corporate awareness of how the Japanese economy operates, and to increase the intermediate and advanced study of the Japanese language in high schools and universities;

- Establish a Deputy US Trade Representative for Japan. This individual would be based in Tokyo and supervise continued MOSS talks. Furthermore, he or she would see that formal complaints of American companies are quickly processed, and, when necessary, considered for adjudication under US trade law;

- Call on the US Department of Treasury to study renegotiating existing US-Japan tax treaties, in order to lessen the excessive tax burden on American companies and their executives in Japan. The goal might be to equalize the tax burden of US companies and their executives in Japan with that of Japanese firms and their Japanese employees in the US.

INTRODUCTION

Revisionism and "Revising" the US-Japan Relationship

Today an ever increasing number of prominent voices in the media, Congress, academia, and industry call on the US government to act aggressively to create a "fairer," more balanced US-Japan economic relationship by "strategically managing" a greater portion of bilateral trade. To a large degree, their pleas have been shaped by the publications and pronouncements of a group of veteran Japan-hands -- the so-called revisionists.

Revisionists strongly reject the core idea that has guided US economic policy toward Japan in the post-War period -- that the Japanese and American economies share an underlying similarity. Disdaining the traditional focus on progressive economic *convergence*, revisionists stress the persistence of *divergence*, pointing out the many underlying ideological, behavioral, and structural differences between the Japanese and American styles of capitalism. Professor Richard Samuels of MIT summarizes the revisionist outlook in a recent review essay:

> The revisionist view is that Japan has a very different conception of the purposes of an economy. Japan's success is nothing less than a "trial of our beliefs." Despite outward looking appearances, Japan does not belong to the group of capitalist, free market economies for which the purpose of economic activity is to benefit the consumer. In Japan, the goal of economic activity is to benefit the producer... Twentieth-century consumers, much like nineteenth-century peasants, have been exhorted to carry a disproportionate burden as Japan struggles to "catch up and surpass" the West...In sum, Japan "plays by different rules"; its "producer orientation [is] a deviation from the logic of capitalism and free trade. Capitalist societies are supposed to respond to price, so as "to get more. Japan does not." Japan is different. Japanese economic planners have moved beyond Adam Smith, and Japanese social planners operate with radically different assumptions about human motivation and "rational" action. The result is that Japan has reinvented the institutions of capitalism.[1]

To meet the Japanese challenge, revisionists urge the US to make dramatic changes in its internal and external policies. Domestic recommendations range widely -- from suggestions by Economic Strategy Institute President Clyde Prestowitz that America adopt a Japanese-style "strategic industrial policy," to journalist's James Fallows' imploration that we just be "more like us" and play the Liberal-capitalist game "like we used to."

"Containing Japan"

While revisionists differ in their prescriptions for the American home front, they generally agree on the substance of a new American foreign economic policy toward Japan. Despite their apparent admiration for Japan's accomplishments as a "developmental capitalist economy,"[2] they identify growing Japanese economic power as a genuine *threat* to the United States and its way of life. They believe that, like Soviet-style Communism, the expansion of Japanese capitalism demands "containment."

In order to craft an effective containment policy to "combat" Japan it is suggested that we "think and do like the enemy." Thus, basically the US must realize that "protectionism pays," and adopt policies similar to those which the Japanese themselves utilize to "strategically manage" trade.[3]

The present US trade approach, based on expanding market opportunities for US business in Japan via sectoral and structural negotiations, is seen by revisionists as grossly inadequate. The revisionist view is that even if *markets* are opened further, the Japanese capitalist *system* -- which is structurally biased against outsider involvement -- will remain an effectively insurmountable obstacle to foreign progress. Moreover, any attempts to pressure Japan into undertaking economic structural reform to make its economy more accessible (as the US has tried within the *Structural Impediments Initiative* (SII)) will inevitably backfire in our faces. According to a former top negotiator for the United States Trade Representative (USTR), and noted SII opponent, Glenn Fukushima, "the Japanese will use SII only to improve the efficiency of their system while not changing its essential properties." Thus, from Japan's perspective, "the Structural *Impediments* Initiative might be better renamed the Structural *Improvements* Initiative."[4]

In summary, as Lee Iacocca, a major intellectual and financial supporter of revisionist scholarship, likes to say, "We can't fight back in Japan even when we try because the Japanese won't let us."[5] According to the revisionists, the situation is close to hopeless as things presently stand. Unless "adversarial trade" from Japan is "contained" and US companies are *managed into* "succeeding" in the otherwise impenetrable Japanese market, a radical economic imbalance will remain built-in to the US-Japan relationship, sapping America of its economic strength and furthering its decline. Iacocca stresses, "How can they continue to shut us out year in and year out without a backlash? I'm not suggesting a real shooting war, but I'm suggesting a great wave of protectionism if they really level us."[6]

Beyond Revisionism

In the following pages we attempt to articulate the intellectual and empirical foundations of a new US strategy towards Japan -- a strategy that moves *beyond revisionism.* Our purpose is not to disprove the revisionists' research on the Japanese economy, but to draw upon and refine -- or even revise -- much of what they have done. We do not attempt to understate the major differences between the Japanese and American styles of capitalism, or to downplay the significant impact that these variations have on the structure of our bilateral economic and political relations. We begin, however, with the premise that given the successes of a wide range of American companies -- small, medium, and large -- in adapting around the world to different business cultures and economic structures, the existence of cultural or structural differences alone should not be used to judge whether US companies are being accorded "fair access" to the Japanese (or any other) market.

Rather, we believe that the question of fairness ultimately should be answered by evaluating whether American companies which progressively adapt to the Japanese capitalist system can succeed. In other words, even if the revisionist critics are correct in saying that the "capitalist game" in Japan is played on a different field and by rather different rules than it is in the US, does it necessarily follow that American companies willing to learn the rules and to play the game cannot win?

The Wednesday Group Japan Research Project

In order to distinguish between rhetoric and reality, the Wednesday Group set out in 1990 to examine how American companies compete with the Japanese on their home turf. This report, *Beyond Revisionism*, and its companion piece, *Insider Capitalism: Economic Culture and American Business in Japan*, are based on extensive background research, using English as well as Japanese materials, and a multitude of interviews with businessmen and government officials in America and Japan.

Additionally, our analytical work draws extensively on the empirical findings of two recent questionnaire-based studies of foreign corporations in Japan. The first, conducted in 1991 by the AT Kearney-International Consulting group for the American Chamber of Commerce in Japan (ACCJ), surveyed attitudes of Chamber members toward the Japanese trade and investment environment. The other, carried out by the Wednesday Group staff in 1991-92, under the supervision of the non-partisan Congressional Research Service, was intended to be a complement to the ACCJ study. It examined how American multinationals understand and adjust to the "soft" aspects of doing business in Japan, such as government and industry relations, to which Japanese firms pay a great deal of attention.

The implications of our research have been translated into policy proposals which are outlined at the end of this paper. We believe that our work represents a major step forward in the trade debate, away from hearsay and panic-induced conclusions, toward a course based on a reasoned analysis of empirically documented reality.

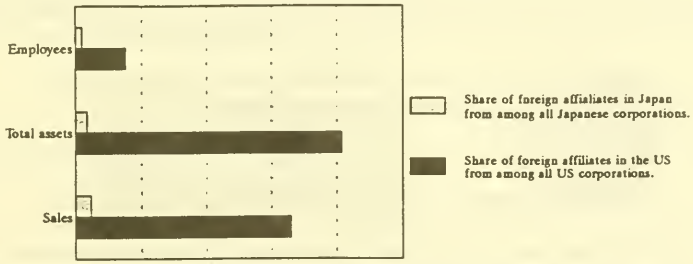
RESEARCH FINDINGS

Our research findings reveal that the situation facing US companies in Japan is neither as dire and lacking in promise as the revisionists claim, nor as optimistic and without need for carefully thought-out, constructive government intervention as some neo-classical economists and pure free-trade oriented politicians might believe. The situation is complicated, and its improvement will require a mixture of actions -- by government, as well as by business, on both sides of the Pacific.

On the other hand, even if American and other foreign companies in Japan were to double their sales over the next five years, they would continue to occupy only a marginal position in the Japanese economy. The products of foreign companies account for a mere estimated 1.2% of all sales in Japan (of which American companies' manufactures account for around 40%).[7] By comparison, in the United States the products of foreign companies account for over 16.5% of total sales (Japanese products occupy about 18% of that total). Additionally, foreign

Graph 1:

Foreign presence in the US & Japanese economies



	Employees	Total assets	Sales
Japan	0.5%	0.9%	1.2%
United States	3.8%	20.4%	16.5%

Source: MITI Office of International Business Affairs, 1992.

corporations in Japan account for only .9% of corporate capitalization and employ only .5% of all employees, while foreign affiliates in the US control over 20% of corporate assets and employ 3.8% of the American workforce.[8] (See Graph 1)

Many internationally competitive American corporations continue to do poorly in Japan or have simply chosen to stay away from the market. Moreover, even some of the most positive US firms we surveyed (many of which commonly are seen as "foreign success stories in Japan") appear hamstrung, having failed thus far to gain anywhere near the level of market share in Japan which they control in the European Community or even in other parts of Asia.

As Brookings economist Edward Lincoln has demonstrated, by international standards, the level of intra-industry trade (cross border trade in similar products) in Japan is extremely low. In his words:

> Rather than accepting an international division of industry in which Japan both exports and imports capital-intensive and technology-intensive products, it tends to export but not to import. This behavior imposes an adjustment burden on Japan's trading partners quite different from the pattern among other nations. American displeasure, in particular, is heightened by the fact that Japan's intra-industry trade is especially low in precisely those industries in which American firms are major world exporters, and in which other industrial nations have high levels of intra-industry trade.[9]

Explaining Low Levels of Market Penetration by Foreign Firms in Japan

A number of explanations have been offered for continued low intra-industry trade levels in Japan in the face of what appears to have been a sweeping liberalization of trade and investment controls over the last 15 years, including the following:

1.) There are systemic or cultural differences which naturally keep foreigners out (as many of the revisionists believe);

2.) Foreign corporations have a "comparative lack of competitiveness;"

3.) Foreign corporations are "unwilling to take Japan seriously;" or

4.) There has been a continuation of Japanese government policies that, in effect, "stack the deck" against foreign competition.

In order to come up with an effective policy response to the Japanese challenge, it is of critical importance to determine which of these explanations is most accurate.

The Cultural Differences Explanation

We find the argument that there are systemic or cultural differences which naturally keep foreigners out is insufficient. Despite what the critics say, our data show that although still problematic, cultural or systemic discrimination is not the major obstacle to foreign progress in the Japanese market. As noted earlier, *provided the rational opportunity*, American (and presumably other foreign) companies are more than capable of comprehending and cracking the system of insider relationships which strongly influence economic transactions in Japan.[10]

Our survey results reveal that over one-third of the firms we surveyed behave in a manner that differs little from the behavior of their Japanese counterparts. In addition to producing first-class products, these firms put a high priority on external relations (*shougai katsudou*).[11] Through *shougai katsudou* they develop long-term ties with key actors in business, the bureaucracy, and politics -- all of whom can open doors as well as close them.

A measure of their success in truly becoming insiders is that more than 30% of our respondents feel that they can contribute to the formulation or administration of Japanese government policies/laws that affect their interests. (See Graph 2) This finding, of course, flies in the face of the claim that while Japanese companies in the US can freely influence the American policymaking and administrative processes, US companies in Japan "are denied reciprocity." In fact, Japanese companies in America probably possess less potential domestic political influence than do American companies in Japan.

Graph 2:

"Do you feel that your company has the ability to contribute to the formulation or administration of Japanese governmental policies/laws that affect its interests?"

Response	Number of firms	Percentage of respondents
Yes	39	31%
No	88	69%

Source: "Insiders and Outsiders American Firms Tackle the Tokyo Loop," House Wednesday Group, 1993

We conclude that although the legacy of Japanese historical isolation certainly lives on, as foreign companies and foreign people increasingly learn how to live as insiders in Japan, Japanese are increasingly accepting them as such. Thus, the existence in

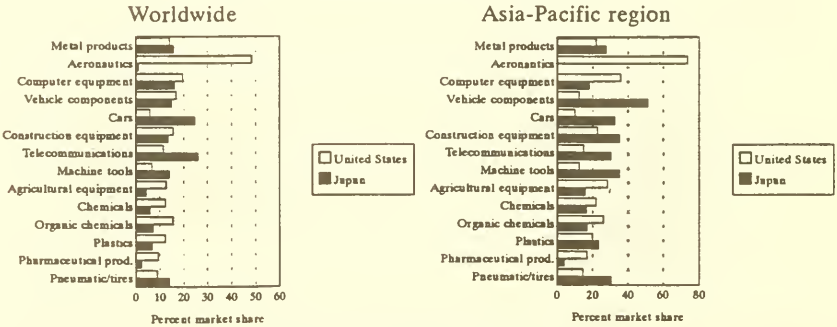
and of itself of a capitalist system that differs from the capitalist system in America has relatively little to do with the overall low level of market penetration by American and other foreign firms in Japan.

The Lack of Competitiveness Argument

We find the second argument, that foreign corporations have a "comparative lack of competitiveness," to be insufficient as well. Although many Japanese business and government leaders apparently believe otherwise, in most major industries American exporting companies remain substantially competitive, both technologically and financially. According to the OECD's 1992 *World Competitiveness Report*, US manufactures ("metal products") account for 14% of worldwide market penetration (22.1% in Western Europe and 16.5% in the Asia-Pacific) while Japanese manufactures have only a slightly higher 15.8% global penetration level (8.2% in Western Europe and 27.7% in the Asia-Pacific region).[12] (See Graph 3) In terms of capital costs as well, on an aggregate level, and despite the burden of the American budget deficit and low savings level, American companies are still in the top six in the OECD (Japan is number four).[13] Finally, the balance sheets of large multinationals, which account for the bulk of trade in manufactures between the US and Japan, confirm that US corporate costs remain competitive with those of Japan. Owing primarily to their great sophistication in raising funds internationally, many of these firms currently have significantly lower capital costs than do their Japanese counterparts.[14]

Graph 3:

US vs. Japanese market share

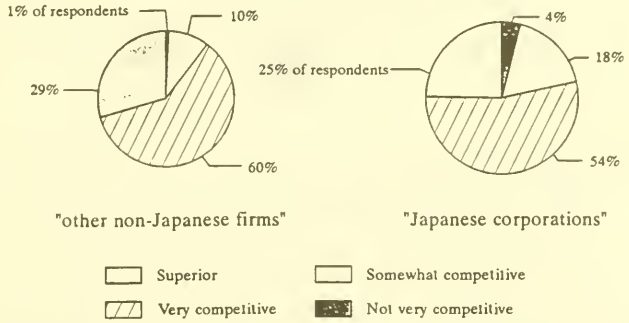


Source: World Competitiveness Report 1992

Although American corporations in a number of major manufacturing industries may be in competitive decline relative to their Japanese rivals, the fact remains that US exports continue to rank in the top five in nearly every major industry in almost every major market in the world. Moreover, nearly 80% of Wednesday Group survey respondents regard their products to be "very competitive with," or "superior to," those of their Japanese rivals. (See Graph 4) Nevertheless, as noted earlier, our respondents' feelings of relative strength have not yet translated, in the vast majority of sectors and sub-sectors of the Japanese market, into successes that remotely compare to their experiences elsewhere.

Graph 4:

"In comparison with the products of (1) other non-Japanese firms and (2) Japanese corporations, how competitive do you feel your company's products are in Japan?"



Source: "Insiders and Outsiders American Firms Tackle the Tokyo Loop," House Wednesday Group, 1993

The "American Multinationals are Unwilling to take Japan Seriously" Argument

We find the third argument, that American multinationals are unwilling to take Japan seriously, unacceptable as well. Given the amazing efforts needed to get into the market in the past as well as today, the multinational companies we surveyed would not even be in Japan if they did not take the Japanese challenge seriously. 84% of

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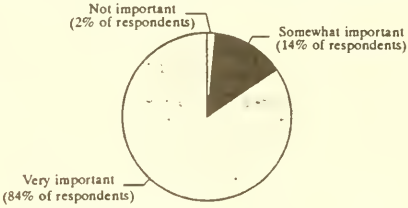
Wednesday Group survey respondents report that selling their products or services in Japan will be a very important part of their future. However, because only a minority of the companies we surveyed appear to be making major efforts to penetrate fully the Japanese business system and become insiders, perhaps it can be said that many large US firms do not take the Japanese way of doing business seriously enough. As noted above, our evidence points to a connection between taking an insider attitude and improving market access. Many US firms would probably profit if they acted on their belief that culture is a barrier in Japan (which 79% of Wednesday Group survey respondents indicated), and did more to integrate themselves into the Japanese business system. (See Graph 5)

Graph 5:

"How important is it for your company's future plans to sell its products and/or services in Japan?"

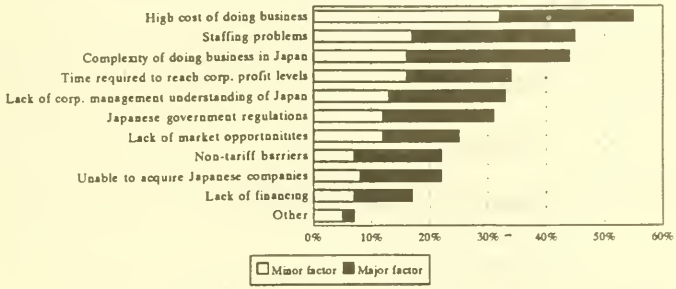


Source: "Insiders and Outsiders American Firms Tackle the Tokyo Loop," House Wednesday Group, 1993

Nevertheless, playing the game like a Japanese insider is frequently easier said than done. Until a company has developed a major presence in Japan, it appears that rationalizing the costs of engaging in external relations activities on a large scale is exceedingly difficult. Our data reveal a distinct correlation between the size of a firm's sales in Japan and its penetration of the Japanese insider network (see the Wednesday Group's companion paper, *Insiders and Outsiders* for more information on this relationship). For most companies, however, the costs of doing business in Japan make it nearly impossible to justify the financial and human resource allocations needed simply to maintain a small base of operations -- let alone rationalize those allocations needed to develop a significant network presence. According to respondents of the ACCJ-AT Kearney International Consulting group survey, the number one barrier inhibiting their greater investment in Japan was the high cost of doing business in Japan. (See Graph 6)

Graph 6:

"What factors inhibit greater investment in Japan by the parent company?"



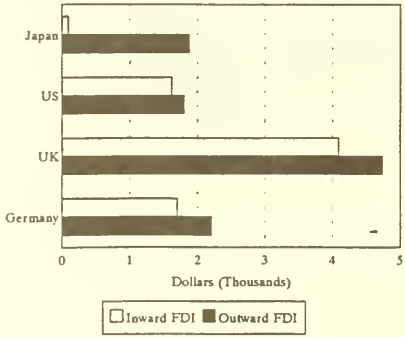
Source: Trade and Investment in Japan: The Current Environment, June 1991

The Argument that Japanese Government Policies Continue to Effectively "Stack the Deck" Against Foreign Investment Needed to Compete in Japan

Based on our research, we conclude that problems of "competitiveness," "commitment," or "systemic bias against foreign outsiders" -- while all of marginal significance -- do not account adequately for the low levels of intra-industry trade in Japan. The main problem holding back foreign corporate penetration of the Japanese market is that the Japanese government continues to maintain a regime of policies which in effect *irrationalize* the playing field for majority-controlled direct *investment* (majority-control is key because a company needs to be the master of its own fate in Japan as elsewhere). As the Japanese government has long understood and a growing number of economists are coming to realize, trade and majority-controlled investment are linked. By first overtly (through an array of investment controls) and then covertly (by deliberately fostering an excessively high cost structure) "stacking the deck" against foreign companies, the Japanese government has radically constrained foreign-affiliated corporate trade in Japan. (See Graph 7) The fact that Japan -- the world's second largest economy -- has only $97 per capita (in 1991) inward direct investment (by far the lowest among OECD nations) largely explains its peculiarly low level of intra-industry trade penetration.

Graph 7:

Inward and outward foreign direct investment per capita (1991)



Source: "Recent Trends in International Direct Investment," US Department of Commerce, International Trade Administration, 1992

The Critical Importance of Direct Investment in International Trade

Undoubtedly, many readers will question our contention that expanding majority-controlled investment in Japan will lead to greater exports of American products into the Japanese market. They will argue, perhaps, that we should invest more at home rather than send our scarce funds abroad. However, such a view ignores the roots of most foreign business "success stories" in Japan, as well as more general evidence of how international trade in manufactures (which largely comprise our trade deficit with Japan) typically works. [15]

For a number of basic reasons, majority-controlled direct investment in a subsidiary in most cases is a prerequisite to sustained overseas trade in non-commodity products. First and foremost, companies usually need their own sales and distribution infrastructure in overseas markets to ensure that their products are fine-tuned, marketed and distributed properly. History shows that US companies which lacked control of these essential tasks frequently have been shortchanged, or simply ripped-off, by their partners or agents abroad.[16]

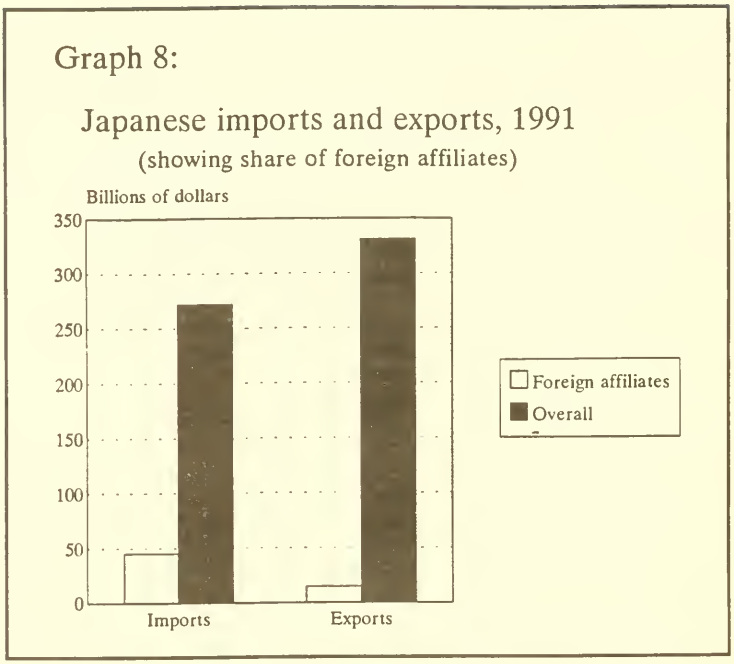
Furthermore, the establishment and maintenance of a fully-owned or majority-controlled subsidiary enterprise via overseas direct investment is important because it

demonstrates a firm's long-term commitment to both its customers and its native employees in the country in which it is operating. In Japan's relationship-fixated, insider economy, a relatively large operational platform based on long-term investment is particularly important. As Dr. Thomas Jordan, Senior Managing Director of Du Pont-Japan, points out, "Foreign companies need to realize that an arm's-length approach does not usually work in an arm-in-arm economy."[17]

Finally, and most significantly, detailed examination of trade statistics confirms that the existence of majority-owned overseas subsidiaries tends to have a *positive* -- not negative -- effect on exports from factories at home. This finding has been documented clearly by Harvard Business School Professor Dennis Encarnation. He observes that majority-owned foreign subsidiaries of American or Japanese companies import far more from their parent firms back home than they procure locally, while he finds that no such relationship exists between parents and minority-controlled subsidiaries. Since 1957, shipments from parent firms to their overseas subsidiaries have composed 65% of all US exports.[18]

Even Japan's Ministry of International Trade and Industry (MITI) concurs that investment has a positive effect on inward trade. A recent MITI policy paper notes that affiliates of foreign companies in Japan imported $45.4 billion worth of goods in 1991 (16.7% of total imports) -- over three times their $14.9 billion in exports (4.5% of total exports). (See Graph 8) Moreover, MITI's figures understate the positive impact that majority-controlled foreign affiliates in Japan have upon imports from their parents. This is because they do not distinguish between majority- and minority- controlled enterprises, and thus do not reflect the fact that the vast majority of foreign-affiliated *exports* are produced by a small number of *minority-controlled* subsidiaries. Overall, a wide range of evidence indicates that increasing the number of majority-owned foreign companies in Japan should significantly increase imports.[19]

Outside Japan, US and Japanese multinationals trade and invest in a remarkably similar fashion. It is only inside Japan that significant differences in their behavior can be observed. Increasing US *majority-controlled* direct investment in Japan will be the key to increasing market penetration and integration by American firms and should have a major impact on rectifying the imbalanced structure of our trade relations and on reducing economic friction. Before examining what will be necessary to expand the level of US direct investment in Japan, first we must look at how the Japanese government has managed so successfully to keep out foreign investment in the past and continues to do so in the present.



JAPANESE POLICIES

It is Hard to Forget History: The Lingering Effects of Investment Protectionism in the Past

The effects of Japan's long history of investment protectionism linger with us today. They are impossible to ignore. At a time when the dollar was strong, when American industrial competitiveness was supreme, and when US firms were rapidly becoming multinational, not only were American companies prohibited from selling their superior products in Japan (often through foreign exchange controls), but in the vast majority of cases they were *even forbidden to invest independently* and manufacture in Japan for its domestic market.

In 1949 and 1950, ironically with the full assistance of the American Occupational authorities,[20] the Japanese government issued two basic laws which radically controlled the investment as well as operational activities of foreign companies in Japan for the next thirty years: first the Foreign Exchange and Foreign Trade Control Law (FECL) and then the Foreign Investment Law (FIL). As economic historian Juro

Hashimoto describes it, "these Foreign Investment Laws were unique in the world," in that they provided the Japanese government a means of strategically restricting not only trade (as many developing countries do) but also investment.[21] According to Hashimoto, the impact of the FIL and FECL "in allowing Japanese firms to concentrate on long-term growth and market share development rather than on short-term profits cannot be underestimated."[22] Lawyer Richard Rabinowitz, who served as chief Counsel to IBM-Japan in the 1960s agrees, remarking that the FIL in many ways was the "linchpin" of Japan's postwar economic development.[23]

The FECL and the FIL were designed "to help improve Japan's current account balance, protect the independence of Japanese corporations from the [threat of] foreign control, and contribute to technological advancement." Basically, the two laws enabled the government to restrict direct investment to foreign companies which (from an industrial-development perspective) could give something to Japan -- something which it was unable to produce or provide for itself -- and then to control their activities in the market through so-called *administrative guidance* (*gyousei shidou*).[24]

Administrative guidance was the principle means through which the nation's bureaucracy, in particular the famed Ministry of International Trade and Industry (MITI), sought to maintain the "organizational coherence" of Japan, Inc. and "steer" the nation's economic growth. Foreign firms were judged to be fundamentally incapable of comprehending the "unique" Japanese concept of government-industry relations and thus were seen as a threat to the guidance system.[25] "For the good of the nation" their entry -- in the words of one senior MITI official "like that of children into a room full of candy -- *had* to be tightly controlled" through the investment law framework.[26]

Official investment protectionism persisted through the late 1970s and early 1980s -- when the FIL was rescinded, the FECL was revised, and "administrative guidance" "policies" were "relaxed" (although not abandoned). In the long interim period, rather than invest in independently-owned and operated ventures, foreign companies desiring to participate in the rapidly expanding Japanese market usually were forced either to accept minority stakes in joint ventures with Japanese firms (typically potential *rivals*) or, worse yet, to simply license their technologies or products.[27]

Even when inward investment and trade occasionally was permitted, it had to come with the consent of those potentially affected. Thus, as the former President of Du Pont once explained, "It was very common to have your company's *competitors* (with the Japanese government's blessing) debating the proposition of your coming in as a direct investor."[28]

GM and Ford: The Struggle to Re-Enter the Japanese Market

A typical case in point is the way in which GM and Ford -- the *two largest auto companies in Japan before the war* -- were treated when they repeatedly tried to re-enter the market following the end of the Occupation. Because the "Big Two" are so criticized today for "neglecting" the Japanese market, the outcome of their past efforts is worth briefly explaining.[29]

Following the post-war Reconstruction Period in Europe, GM, Ford and other American companies easily were able to reestablish their own large subsidiaries in France and Germany. In Japan, however, following the Occupation nearly all foreign firms, including GM and Ford, were summarily kicked out of the country on the grounds that they "might disrupt the reconstruction of economic order."[30] By the late 1960s, Japan had fully recovered from the War, become a full member of the GATT, and appeared committed to progressive liberalization of tariff and capital controls. Believing that the "new Japan" would allow them back into the country, GM and Ford attempted to *re-invest, pursuing the goal that they had achieved elsewhere* of setting up fully-owned and operated subsidiaries. Contrary to expectations, both corporations encountered nothing but trouble.

Feeling frustrated with the slow progress of his company's re-entry negotiations, in October 1968 Henry Ford II recruited IBM President Arthur K. Watson (whose firm already had been allowed back into Japan, but had found itself handicapped by excessive government regulation). Together Ford and Watson set up a meeting with the Chairman of Nomura Securities, Okumura Tsunao, and a number of other Japanese business leaders. The objective of this highly unusual gathering of top American and Japanese industrialists was to discuss why US multinationals were being so egregiously shut out of both trade and investment in the Japanese market. As the meeting began, Ford reportedly turned to the Japanese group and declared, "We can't, and won't...tolerate the one-way street of automotive trade between Japan and America." Later, with things getting hot, Watson backed up his friend Ford, noting that in the computer industry, as well, IBM and other foreign corporations faced far greater discrimination in Japan than they did in any other country in which they did business. Watson asked only that the Japanese learn to "accept the basic logic of international commerce -- *that those who wish to compete abroad must accept competition at home.*"[31]

Regarding the outcome of this extraordinary face-to-face foray and other similar efforts to gain reciprocal access, Yale University business historian Mark Mason writes in his recent history of foreign direct investment in Japan:

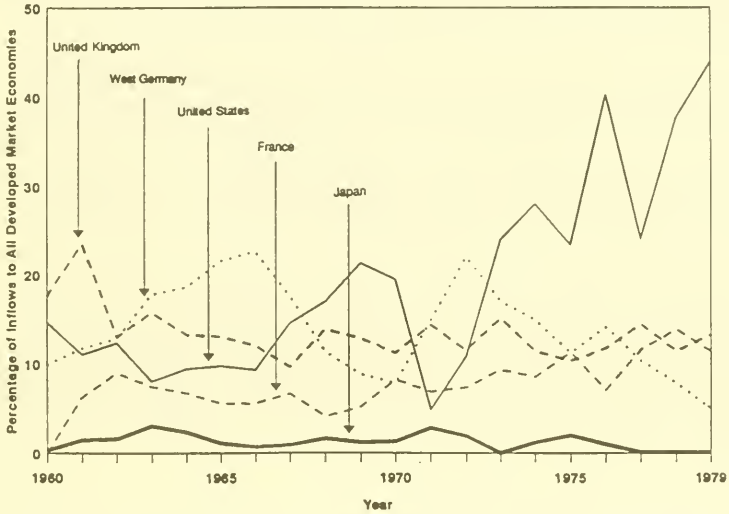
> This foreign pressure did not, however, persuade the Japanese authorities to lift public controls. Government officials explained that the domestic auto industry in the late 1960s was badly fragmented and

> grossly inefficient -- no fewer than 10 Japanese auto companies produced automobiles, they pointed out, for example -- and that foreign entrants might well overwhelm local firms.[32]

Under the circumstances, both Ford and GM felt that they had no choice but to accept what was offered to them -- minority-share arrangements in two of the weaker Japanese companies (Isuzu and Matsuda), despite their hopes to either acquiring a top flight domestic producer or investing independently. As an in-house GM study concluded at the time, "the choice is between participation in the automotive industry through a joint-venture, or effective exclusion from the largest vehicle market outside the US"[33] In retrospect, a senior GM-Japan manager interviewed for this project commented, "When people in Japan or the US complain about GM's relative absence from the Japanese market, they should not forget the past. We certainly would not be in the position we are in today in Japan, if we had been allowed to do our fixed investment in distribution twenty or thirty years ago, as we tried."[34] The following graph from Mason's book, American Multinationals and Japan, shows the results of Japan's policies regarding foreign direct investment:[35]

Graph 9:

Direct Investment Inflows to Select Developed Market Economies, Percentage Distribution, 1960–1979



From Formal Investment Protectionism to Cost Protectionism:

In the 1980s, just when companies like Ford and GM thought that they might finally get the chance to enlarge their market positions, the fixed and operational costs of doing business in Japan skyrocketed -- once again irrationalizing the investment playing field. Radical cost inflation, for the most part, was not the result of natural market forces working in a liberalized environment, despite what some may assume. The domestic Japanese economy, in a number of key areas (such as the real estate and financial markets) was anything but liberalized. Rather, rising costs were part of a government strategy designed to facilitate the expansion of Japanese trade and investment overseas while minimizing the effects of liberalization at home. We term this new invisible approach to protecting the Japanese market: *cost protectionism*.

Land Policy, the Plaza Accord, and the Birth of the Bubble Economy

Since the end of the Occupation era, as a major industrial policy objective, the Japanese government has deliberately tried to restrain the rational development of the nation's scarce land resources through tax, zoning, and rent-control policies designed to stifle market liquidity and efficient usage. The avowed purpose of these *anti-market* land policies has always been to direct available economic resources (i.e. income and accumulated savings) away from consumers interested in home ownership or improvement and toward producers building products for export.[36]

Following the 1985 Plaza Accord (which caused the Yen to appreciate versus the dollar), the Japanese government began to apply a tremendous monetary stimulus to the economy. Ostensibly the rationale for letting down the monetary floodgates was to enlarge domestic market demand as a means of furthering the reduction of Japan's trade surplus with the US that the Accord had set in motion. However, in reality, the government's main objective was to help Japanese corporations, which were determined not to lose market share overseas, successfully cope with the rising strength of the Yen.

The impact of its actions was awesome. The flood of currency pouring into the economy served to hyperstimulate domestic demand, putting bundles of low-interest Yen into the hands of those wishing to buy land in the nation's capitol (which had been identified by the government in its fourth national plan as the "place to be in the twenty-first century"). Not surprisingly, enlivened demand for available property rapidly outstripped the artificially meager supply. Thus, ensued a speculative "bubble" on a magnitude greater than anything previously experienced in the world.

The Dimensions of the Bubble

The pace and scale of land price appreciation was unbelievable. The "average" value of a square meter of land in Tokyo at the beginning of 1986 was around 1 million Yen ($5,935). Two years later the average had more than doubled to 2.13 million Yen (around $16,640 -- given the Yen's appreciation)! In fact, by 1988 Japan's theoretical land value had risen to four times that of the United States -- a nation 25 times its size![37]

Japan's stock market soon became the second bastion for speculative investment. With the explicit encouragement of the Ministry of Finance, Japanese banks allowed companies to take out loans against up to 80% of their current land values. Using their wildly inflated property assets for leverage, firms engaged in so-called *zaiteku* (high tech finance) speculation in the equity markets. As a result, the *Nikkei* index of leading stocks more than tripled between 1985 and 1989 (leading it in theory to soundly exceed the value of the much larger New York exchange).

The "Money Machine"

The Japanese government had created what journalist Robert Cutts described in the *Harvard Business Review* at the time as a "money machine" fueled by "land money" based on "a kind of double leveraging of the land itself: capital value reflected in land prices *and* in share prices, the latter realized as cash through liquidity that land speculating had created." The more that the stock market rose, the more that stock values (also highly leverageable under Japanese regulations) in turn could be used to finance greater land purchases. It appeared as something of a "never-ending circle" in which insiders could not lose.[38]

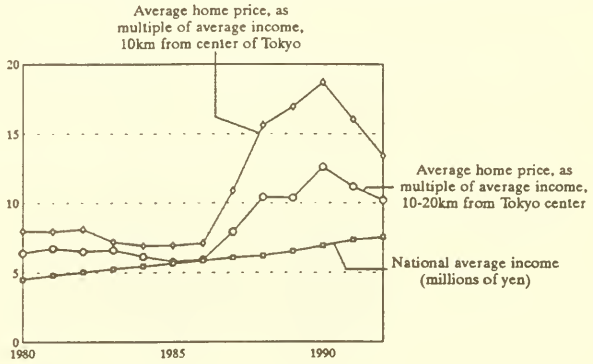
Capitalizing upon this "virtuous cycle" of compounding asset and stock values, Japanese companies not only were able to revive export competitiveness in the face of the appreciating Yen, they also were able to expand their operational boundaries greatly. On the homefront, the benefits of the bubble made it possible for companies to invest tremendous amounts of money in new plant and equipment, streamline existing operations without lay-offs, and write down accumulated debt-loads. Outside of Japan, the bubble empowered both major and minor *kaisha* (companies) to roam the globe buying up real estate and expanding their foreign production capabilities with seeming impunity. Japanese overseas investment from 1980 to 1990 alone expanded more than 10 times.

Casualties of Cost Protectionism: Japanese Consumers and Foreign Producers

What benefitted Japanese business hurt both Japanese consumers, searching for a lifestyle truly reflective of their accumulated wealth, and, to an even greater extent, foreign companies, seeking long-deprived access to the Japanese market. Ironically, just when increased affluence should have made it attainable, the dream of Japanese urban employees to live in a decent-sized house somewhere in the remote vicinity of their workplace was shattered by the artificially created reality of rising real estate prices. For example, between 1980 and 1990 the ratio of average yearly income to the cost of a "normal" sized (which in Japan means small) home located within 20 kilometers of the Tokyo city center, more than doubled. (See Graph 10) As a result, the only way one could afford to purchase an urban "dream house" was to take out a mortgage repayable, not over the course of 20 or 30 years, but over a 60 to 100 year span, committing one's children or even "unborn descendants" to the task of fulfilling the debt obligations of their dead ancestors. Apparently, thousands of people felt compelled to make such outrageous commitments.[39]

Graph 10:

Average home price and average annual wage



Source: *Baburu no Keizaigaku*, (The Economics of the Bubble), *Nihonkeizai Shimbunsya*, 1992

With incomes increasing, those unwilling to mortgage their family's future to buy a home were forced to find other ways to improve their standard of living. For example, many stuffed their cramped living spaces with all of the latest hi-tech consumer

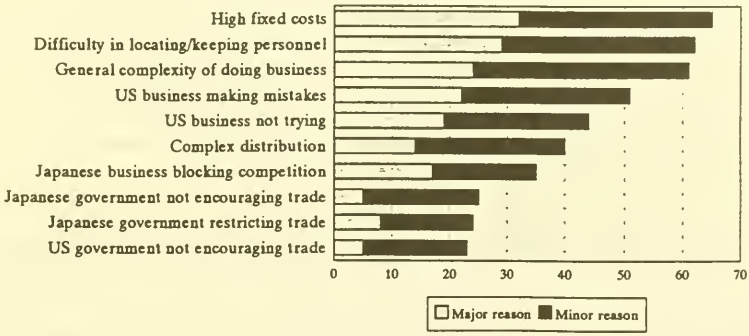
gadgets rolling off the assembly lines of Japanese consumer electronics makers. These were typically purchased at domestic list prices which were frequently more than 50% higher than prices for the same product sold abroad (thus indirectly subsidizing the product manufacturer's international price competitiveness).

But a rabbit-hutch can only accommodate so much. Therefore, as the government intended, the Japanese savings rate remained remarkably high. It was kept there less by a popular "spirit of frugality" than by the inability of the average Japanese citizen to do the one thing that poll after poll indicated he or she most desired-- to buy a new home, or improve an existing one. In line with the industrial-policy objective, "excess savings" only added more fuel to the already-overpowered "export machine."

From the perspective of foreign firms, the costs of the bubble were even greater. Rising costs compounded by the escalating value of the Yen (which was supposed to *improve,* not worsen, foreign business prospects) effectively *irrationalized* the basic direct investment foreign firms need to do business in Japan. Ironically, this occurred just as such investment should have been flowing into the country in response to the substantial opportunities produced by liberalization. In the 1991 survey conducted by the ACCJ, 65% of respondents cited the "high costs of fixed investment" as the *number one barrier* to increased penetration of the Japanese market. (see Graph 11) 64% identified "high land costs or high rents" as the primary Japan-side issue affecting their ability to do business in Japan.[40]

Graph 11:

"Which... are reasons for companies being unable to better penetrate the Japanese market?"



Source: Trade and Investment in Japan: The Current Environment, June 1991

The Japanese government, through policies which fostered land-price inflation, created what was effectively a new protectionist wall -- disguised by the trappings of a "liberalized" market economy. Protected by the rising wall of high costs Japanese companies were able to reap all of the benefits of free trade abroad while remaining effectively sheltered from "foreign invasion" at home. As the President of a large Japanese electronics company puts it, "Outside of Japan *we* suddenly could go almost anywhere and buy almost anything, while inside of Japan *you* could go almost nowhere and could buy almost nothing. This is just what we had prayed for."[41] Testifying to the startling effectiveness of cost protectionism, by the end of the decade the ratio of Japanese direct investment abroad to foreign direct investment in Japan was 20 to 1 in favor of Japanese interests moving overseas.[42]

Cost Protectionism – Not Naturally High Costs

As suggested above, extraordinarily high real estate prices (which prop up the cost structure of the whole economy) in Japan are not a "natural phenomenon." Many prominent Japanese economists have documented in great detail the extent to which the so-called "land problem" (*tochi mondai*) exists for reasons largely divorced from economic logic.[43] Instead it is the result of government policies -- such as those controlling land zoning, leasing, and taxation -- which blatantly favor the status quo of market illiquidity and inefficiency.[44] In the words of Japan's foremost expert on the land problem, Professor Yukio Noguchi, of Japan's top economics school, Hitotsubashi University:

> The land problem in Japan has been caused not by natural constraints such as the absolute scarcity of land, but by economic factors, in particular distortions in the tax system and the excessive protection of tenants by the Land and House Lease Laws. This means that the land problem is, in principle, solvable. If the Land and House Lease Laws are completely abolished and the distortions in land taxation are removed, the land problem we face today will become far less formidable. Under this circumstance, the supply of space would increase substantially, and the prediction of the National Land Agency...that Tokyo should have enough space to accommodate an additional five million more people in a far more comfortable environment could become a reality.[45]

The extent to which the "land crisis" is an artificial creation is illustrated clearly by a host of current statistics. For example, a recent Japanese governmental study found that "approximately 160,000 acres of land remains within the greater Tokyo area that can be developed into housing tracts." Equally stunning is the fact that the average building height in Tokyo is only 2.8 stories (many third world cities are taller). Moreover, contrary to the myth propagated by certain bureaucrats, building height has no relation to earthquake safety. According to Construction Ministry officials, the

safest buildings in Tokyo are in fact the taller, newer structures. Still, the government does everything it can to ensure that Tokyo grows outward rather than upward. As a result, currently only 40% of the Tokyo building code's "authorized [height to building footprint] ratio is actually utilized."

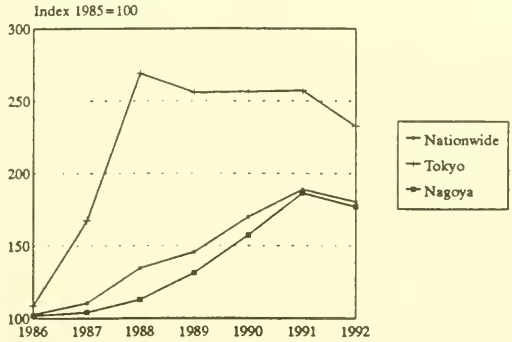
"The Bursting Bubble?"

Although land prices finally have begun to decline of late (quite precipitously in some areas) and the stock market has crashed, speculation that the "bubble economy" has "burst" in many ways is unfounded. (Graph 12 shows the recent decline in real estate prices.)

Graph 12:

Japanese Real Estate Prices

Nationwide, and for two large cities



Source: Tokyo no Tochi (Land in Tokyo) 1992

Price/earnings ratios on the "bust" Tokyo Stock Exchange still exceed those of the booming New York exchange by more than 40%. Further, in dollar terms, overall land costs are still almost twice what they were at the beginning of the decade (and comparably almost 4 to 5 times what they are in other major cities in the world). A survey published at the end of 1992 showed that a square meter of land in downtown

Tokyo still averaged $6,000; a comparable "spot on the ground" in Los Angeles would have cost approximately $108. Equally, office and apartment rents (while certainly on the decline) continue to be more than twice as high as those in New York -- America's "cost capital." Demand still greatly outstrips supply. What the highly-respected economic weekly *Toyo Keizai* (*The Oriental Economist*) on January 23, 1993 called a "precipitous decline" in building occupancy in Tokyo's prime Shinjuku ward office district, in reality, was only a petty change: from 99.5% to just less than 96%![46]

The bottom line is that Japan remains an incomparably expensive place in which to invest, operate, or live. Japan's top industrial body, *Keidanren*, openly admits this in an October 1992 report on the Japanese foreign investment climate: "Although the high land prices in Japan's major metropolitan areas are starting to show a downward trend due to the bursting of the economic bubble, they are still very high compared to other countries, with various government policy measures providing little in the way of noticeable benefits. With little hope that land prices will decline sharply anytime soon, the high cost of land will continue to keep initial costs associated with new investment into Japan higher than in other countries, and reduce expected return of investment."[47]

Cost Protectionism Continued: The Bubble Within the Bubble

The reason prices will remain much higher in post-bubble Japan than in other places where bubbles have burst is that the underlying policies which led to the bubble's creation in the first place (such as hyper-regulation of urban land and excessive capital market interventionism by the Ministry of Finance (MOF)), remain untouched. There is still almost no effective taxation of property and the capital gains tax on land transactions is extremely high. As a result, liquidity in the land market nationally is still only around 1% on an annual basis. Equally, the MOF continues to act as if "Japan has surpassed capitalism" -- to quote the title of a book by one of its senior officials, Eisuke Sakakibara.[48] On a daily basis MOF attempts to fool world markets by "guiding" massive amounts of cash (reportedly approaching $47 billion in 1992 alone!) into theoretically-bankrupt financial institutions to keep them "afloat," rather than closing their doors, refunding depositors, and letting the market "clear." As long as such anti-market policies are maintained, a "bubble within the bubble" will remain inherently inflated inside the economic structure.

Japanese Cost Protectionism and Japan's Trade Surplus

Eliminating Japan's cost protectionist policies would also be likely to help in reducing Japan's bloated global current account surplus (i.e. that in goods and services). As

we note above in our discussion of the effect of high costs on foreign direct investment, anti-market land policies prevent Japan's scarce urban land resources from being developed in a rational manner. The current policies radically constrain the supply of available commercial, industrial and residential property in urban areas. This constraint sends land prices to absurd levels as demand massively outstrips supply. The ultimate effect is that Japanese consumers-- deprived by outrageous costs of the potential to invest rationally in new or improved homes-- save far more money than their counterparts in other countries.

The connection between Japan's high savings rate and its large current account imbalance may be explained in two ways -- from the macroeconomic perspective, and the microeconomic. From the macroeconomic viewpoint, high savings removes income from potential consumption, and thereby suppresses the potential market for imported goods. The view from the microeconomic level is somewhat more complicated. First, the great supply of savings lowers the cost of capital, and therefore lowers the cost of investment. Because the price of land in Japan is prohibitive, an usually large pool of money is available for plant and equipment investment (which Japanese tax laws favor). This, combined with their ability to freely leverage appreciating real estate and stock assets, enabled companies over the last ten years "rationally" to *over-invest* in expanding productive capacity -- even when such capacity is already in surplus. Such "excess investment" further fuels Japan's already over-energized export machine, and thus forces Japanese consumers to suffer for the sake of industry. The overall effect is that Japan possesses the most inefficiently-developed and most costly land resources in the industrialized world, as well as an industrial structure that is biased toward surplus exporting. These macro- and micro-economic structural realities help explain why Japan today has current-account surpluses of historical dimensions with <u>all</u> of its major trading partners.

We can only imagine how much better off the Japanese people and Japan's trading partners might be, were the government to abandon cost protectionism and truly liberalize its domestic market. For example, if the Japanese government were substantially to reverse its present course -- i.e. abandon its anti-market land policies and economically stimulate the comprehensive development of its scarce land resources -- consumers and investors would suddenly take advantage of opportunities to purchase or develop tracts of property rationally. Property costs would fall, supply would increase, and the savings rate would decrease. As consumption rose, imports would also increase; domestic demand would suck up more products currently destined to be exported; and as the pool of "excess" savings drained, "excess" industrial investment would shrink to more modest levels.

Moreover, as a result of the Japanese consumer's new capacity to develop property rationally, the size of the average Japanese home would likely grow. This development, in turn, would expand the market for consumer goods, as consumers would rush to furnish their new and improved homes. In this scenario, Western

manufacturers would benefit especially, because their products are generally designed according to a larger scale than is currently appropriate in much of Japan. Thus, for example, in order for Amana and Whirlpool to sell in Japan, their refrigerators and washers would no longer need to be redesigned according to "rabbit-hutch" specifications. In short, consumers and foreign exporters to Japan might finally get their fair share of the benefits of Japanese economic growth. Japan's current account imbalance, which is driven to a great extent by savings differentials between Japan and its trading partners, would not disappear. However, its size could be reduced substantially.

TIME FOR A CHANGE

Japan Dis-incorporated and the Rising Potential for Foreign Market Access

Today, the potential appears to be growing for foreign companies to penetrate the Japanese market and to succeed as genuine insiders. In spite of Japanese government attempts to "control the situation," Japan's insider economy is slowly turning outward in a manner which should expand American business prospects.

As a benefit of the recessionary economy, an increasing number of cracks are appearing in the previously seamless *keiretsu* industrial groupings. Longstanding affiliated supplier and producer relationships have become brittle under the pressure of market restructuring. Some subcontractors, facing threats by their *keiretsu* partners either to increase their productive efficiency and quality of output, or to face the consequences, are reportedly failing to meet these demands and are being abandoned.

This atypical discord should represent an opportunity for competitive, well-positioned and committed foreign companies to break into the Japanese system via independently controlled direct investment, or even through a white-knight acquisition of an ailing firm. Nevertheless, notwithstanding the growing potential for foreign business to make headway in the Japanese market, one major obstacle remains in their path.

Japan: Ever the More an Outlier

The possibility of a dramatically increased foreign business presence in Japan continues to be undermined by "cost protectionism." Even with the perceived "bursting of the bubble," costs in Japan are still far too high (relative to costs in other major markets) to attract the interest of many large American or other multinationals--let alone that of small or medium-sized firms. American corporate experiences in Japan contrast with their experiences elsewhere, even in nations that have only

recently acknowledged the right of individuals to hold private property and the legitimacy of the market economy system. For example, as is evidenced by their rapidly increasing trade and investment there, American companies reportedly find The People's Republic of China today to be a much more favorable place to do business than they have found Japan to be at any time over the last forty-five years. Such a contrast has fueled disillusionment with Japan as a "fair" trading partner. This frustration is being compounded further by changes in the strategic environment in East Asia, such as the dissipation of the overriding threat of Soviet expansionism, that are drawing attention away from the security aspects of Japan's relations with America toward those of the economic realm.

Essentially, what people are realizing is that the old rationale for maintaining a "special US-Japan relationship" may not easily translate to the post-Cold War world. A potential crisis is on the horizon. In order to avert serious deterioration, we firmly believe that aggressive actions must be taken to set the relationship on a new solid footing geared toward the future, not rooted in the past.

The need for A New, Post-Revisionist US-Japan Trade Policy based on Constructive Engagement, not Containment

With the end of the Cold War, economics has come to influence the US-Japan relationship as greatly as politics and security. In order to address this "new reality,"[49] we believe that a new US approach toward Japan is essential. As we see it, unless one sees hope in the continuation of past policies of "benign neglect," we must change our approach toward Japan.

One approach -- touted by revisionists and micro-level industrial policy advocates-- calls on the government to manage bilateral trade in areas which are deemed "strategically important." In Cold War terms, this is pure containment theory in action. The US government's containment approach during the first part of the Cold War (which regarded underlying sources of conflict as unsolvable) contributed to increased East-West tensions. Whatever the merits of containment in a Cold War context, such a strategy applied to the economic relationship between the United States and Japan is simply inappropriate. An economic containment strategy towards Japan would be likely to increase US-Japanese political, as well as economic, tensions, and, moreover, would fail to bring about a fundamental improvement in the position of US companies in Japan.

A different, and what we believe to be a better approach, is to largely forsake government interference in the ultimate market of goods and services and focus instead on micro- and macro- *input-factors* which affect the behavior of firms. This is analogous to the *constructive engagement* strategy employed by America in the later stages of the Cold War. It emphasizes long-term mutual benefits rather than short-

term relative gains. It addresses underlying causes of friction through active engagement of structural differences -- not necessarily in the hope of eliminating such cleavages, but with the goal of minimizing their impact on political and economic relations. Such a positive approach is, in many ways, a much more difficult and demanding strategy to implement than its alternative. Nevertheless, the hard work of constructive engagement will produce lasting hard benefits for American business and government, while the quick-trigger action of containment would produce nothing more than ephemeral relief for industry and destabilize our still important political relationship. In short, where containment is about bridge burning, constructive engagement is about *bridge building*.

Constructive Engagement in Action

Thus, we believe that the US government should neither tell the Japanese consumer which products to buy nor constrain the activities of Japanese companies in the US via managed trade. Rather, we propose that the US government pressure Japan to eliminate policies which make it the most expensive country in which to operate in the world. The benefits to American and other foreign companies attempting to do business in Japan of ending cost protectionism (and any remaining areas of overt protectionism) will be exceeded only by the benefits to the Japanese people, as they will finally reap the fruits of their considerable wealth and improve their standard of living.

Although the drop in the Japanese real estate and stock markets should be seen as an opportunity for rapid action, it is unrealistic to expect that far-reaching changes in the cost structure of the Japanese economy will come about quickly. In the interim, therefore, the Japanese government should be encouraged to give something along the lines of "host nation support" to foreign businesses. This would effectively create "cost-countervailing measures" which would entice competitive American and other foreign firms *rationally* to invest in Japan, while allowing the market to determine which firms succeed or fail. Japan should not be asked to *level* its economic playing field to exactly resemble our own, but it must do much more to *equalize* it for American and for other foreign firms who were prohibited from entering Japan when costs were reasonable.

Understanding the benefits of greater direct investment, Asian countries such as Singapore and even China have adopted major programs to lure foreign corporations to their shores. The Japanese government as well has begun to step up efforts to increase trade and investment. Thus far, however, its self-billed "aggressive promotion program," pales even in comparison with those programs that many *individual* American states have created to attract Japanese investment. Furthermore, since cost and cultural barriers are much larger in Japan than in the US incentives to foreign businesses must be considerable to be effective.

The US Share of the Burden

Reading this report, many Japanese will undoubtedly complain that our proposals are excessively one-sided and that they fail to address the macro-economic problems which are sapping US companies of competitiveness. We agree that in order to regain the broad-based national competitiveness it once had, the United States needs to go through a period of domestic structural improvement (what the Japanese call *kokunai kaizen*). Each of the measures that the Japanese government recommended that the US adopt during the Structural Impediments Initiative talks-- from lowering the federal deficit in order to free up more low cost money for R&D and plant and equipment investment, to strengthening educational standards-- are important and should be pursued.

At the same time, however, we hold that the burden of dealing with the trade imbalance and idiosyncratic "competitiveness" problems that American and other foreign firms (as well as Japanese outsider companies) encounter in Japan today rests far more on the Japanese government than on the American, or any other foreign, government. As we noted earlier, a tremendous number of US and other foreign companies who are competitive in most other major markets going head-to-head with Japanese firms, are scarcely present in Japan, or do not actively pursue trade at all. With respect to this problem, Japan is at fault, and now that it can afford to make amends, it must do so.

This does not mean that the US should simply sit idly by and wait for its companies to increase investment and trade with Japan, while the Japanese government makes necessary changes. The process has to be two-way. Thus, in addition to pursuing the above-mentioned macroeconomic improvements, we suggest that in the short-to-medium term the US government consider an array of measures and initiatives designed to help improve the US corporate position in Japan.

Policy Proposals

In response to the problems identified in this paper, the members of the Wednesday Group will further consider the following:

MACRO-LEVEL PROPOSALS:

- Replace the bilateral Structural Impediments Initiative (SII) talks with Structure, Trade, Investment, and Competitiveness (STIC) talks. The goal of these talks would be to eliminate Japan-side barriers to increased US trade and export-facilitating investment in Japan. Unlike the SII, STIC would not be geared toward creating a more "Americanized" Japan, but only one in which foreign companies could gain fairer access to the

economic system and compete as insiders. The STIC talks should be conducted in cooperation with the EC and APEC (Asia Pacific Economic Cooperation). This would underline to the Japanese Government the fact that problems with the Japanese market are not confined to US companies -- but are equally experienced by all of Japan's major trading partners.

- Reinvigorate the Market-Oriented Sector-Specific negotiations (MOSS) in all areas in which foreign companies are inhibited by regulatory or tariff barriers from becoming fully integrated into the Japanese market.

- As an interim measure, the Japanese government should be called on to offer significant "bridge incentives" to minimize the "excess" costs of new investment in Japan (as compared to other advanced industrialized nations).

  -- This position is reasonable, given the decades of US toleration (inspired by the Cold War) of overt restrictions on trade and investment in Japan. The US has given Japan fair access to its economy while at the same time protecting Japan's strategic interests regionally and internationally.

  -- The Japanese government has already initiated a number of programs to facilitate direct investment and trade. Nonetheless, its efforts remain insignificant when compared to those which American states like Kentucky and Tennessee on their own have offered to facilitate Japanese investment.

  -- The goal should not be to guarantee "success" for companies investing in Japan, but to give those that can compete with the Japanese the chance to do so on Japan's home turf. This way the market, not some government industrial or trade policy maker, would ultimately decide who wins and loses.

  -- In addition, a number of non-tariff barriers remain in place in scattered sectors and sub-sectors of the Japanese economy. These range from discriminatory regulations aimed at foreign telecommunications products, to a general unwillingness by the Japanese to accept American Environment Protection Agency (EPA) and the Food and Drug Administration (FDA) data in applications for new-product licensing. Although we believe that the problems associated with these barriers have much less of an overall impact than those associated with cost protectionism, we agree with such organizations as the ACCJ that these fragments of Japan's overt protectionist fabric should be eliminated.

MICRO-LEVEL PROPOSALS:

- Increase the trade promotion, advisory, and problem-solving infrastructure available to US companies in Japan by constructing a US-Japan Trade Development Center. The facility would embody a new government-business partnership toward increasing US corporate penetration of the Japanese market. It would house the export promotion offices of industry associations, state governments, and the Foreign Commercial Service -- all of which are under-represented in Japan.

- Increase the Commerce Department's APEC-Industry Cooperator Program funding to underwrite partially the establishment of many more US Industry Association offices in Japan. (All of which could be housed eventually in the Trade Development Center).

- Create a new Deputy US Trade Representative for Japan. This individual would be based in Tokyo (perhaps within the US-Japan Trade Development Center) and would be empowered to address sector-specific disputes on a constant basis, and, when necessary, to set priorities for action under US trade law.

- Establish a number of *design-in* "incubator" facilities in major industrial producing areas in Japan to spur on the integration of more small- and medium-sized American manufacturers into Japanese corporate supply networks. The incubator would provide low-cost office space to companies for an initial year to two year period as well as extensive matchmaking, education, and advice services.

- Call on the Department of the Treasury to study the renegotiation of existing tax treaty clauses in order to lessen the excessive tax burden on American companies and their executives in Japan.

- Create financial incentives to encourage *trade-facilitating* direct investment in Japan.

- Launch a government-industry joint initiative to educate companies and their executives about the Japanese economic environment and Japanese language and culture (as the EC has done with great success).

- Facilitate greater study of Japanese language in the US at the intermediate and advanced levels, by increasing the number of so-called FALCON (Full-Year, Asian Language Concentration) Programs. In addition, to further enhance Americans' understanding of Japan, new

programs could be established to increase corporate awareness of how the Japanese economy operates.

- Partially restructure the mission of the United States Information Agency in Japan to include educating American businessmen about the Japanese business culture as a major objective.

- Authorize the State Department to begin negotiations with the Japanese government to settle certain copyright infringement issues. This has prevented the US government from distributing to business the tremendous volume of Japanese-language science and technology (S&T) and business-related material that the Foreign Broadcast Information Service translates daily.

CONCLUSION

Constructive Engagement and the US-Japan Business Relationship

In conclusion, despite all of the negative rhetoric it inspires, Japan is the home of over 120 million well-off and highly-educated consumers and a large number of the world's leading companies. *The costs of not taking on the Japanese on their home turf are becoming prohibitively high for American industry.* Failing to become integrated into the Japanese corporate network undermines the competitiveness of American companies internationally versus their Japanese counterparts. US companies must be willing and able to penetrate the heart of the Japanese economy. They must no longer be content to reside at the periphery or to cling to the belief that no matter how hard they try they cannot succeed as they do in other markets.

However, the American and Japanese governments must realize that the low level of US corporate participation in the Japanese economy is not simply the result of management's unwillingness to adapt to the Japanese way of doing business. *Whatever the costs of continuing to avoid Japan may be to American global competitiveness, if companies cannot afford the expense of doing business in Japan, they will not do business in Japan.*

The time has come to take a hard look at where the United States is going and where it should go. With the Cold War over, the focus of the US-Japan relationship has shifted away from external political threats to internal problems of economics and business competitiveness. In America, turning inward has led in the past to the adoption of self-centered protectionist policies. Yet today the power of the government to constrain trade is limited. Due to the increasing reliance of American manufacturers on Japanese suppliers and the affinity of American consumers for competitively-

priced, high-quality Japanese goods, it would be very difficult to shut Japan effectively out of the US market.

At the same time, however, a deepening trade relationship between the US and Japan is a good thing only to the extent that it benefits both parties equally. Structural *dependence* of American manufacturers on Japan must be distinguished from structural *interdependence* between American and Japanese companies. Interdependence will foster political harmony between our nations, while dependence fosters only mistrust and fear. This is especially the case when the exclusion of foreign business from Japanese markets is generally caused by Japanese government policies rather than by the strength of Japanese producers.

The Japanese have a saying: "the nail that sticks up gets hammered down." The Japanese government and people must realize that due to their pattern of unbalanced trade and investment, Japan today appears internationally like a protruding nail. The impotence in Japan of otherwise internationally-competitive American companies, compounded by the inability of the American government to effect solutions to trade imbalances, threatens to dissolve the bonds of trust which have united America and Japan throughout the Cold War era. Unless more American companies become as indispensable a part of the Japanese economic system as many Japanese firms have become in the US, Japan will be seen as taking from, but not giving to the US. In spite of our dependence upon trade with Japan and Japan's dependence upon open US markets, popular enmity will certainly rise.

The US-Japan relationship will not simply disappear, but it may well become increasingly weak. If our perceived sense of commonality and fair play is undermined by reality, we will have fewer reasons to work together. Coming at a time when close US-Japan cooperation is extremely important for the maintenance of international peace and economic stability, such a scenario could well be disastrous.

Professor Ernest May, of Harvard University, is fond of telling his students that "history does not repeat itself, it just rhymes." The current rumblings of past resentments between America and Japan testify, perhaps, to the grain of truth in Professor May's dictum. However, in the end, the future need not rhyme with the past. Today, a new course for US-Japan relations can and must be set. Systemic differences and lingering barriers cannot be wished away. On the contrary, they must be confronted and constructively engaged. We must strive to create real political and economic interdependence, and cease fostering, intentionally or unintentionally, unilateral economic or political dependency. Government and business on both sides of the Pacific must realize that although the cost of action may be high, the cost of inaction is certainly much higher. At stake is not simply the economic and political relationship between two great nations, but the future well-being of the entire world.

Endnotes

1. Richard Samuels, *Japanese Political Studies and the Myth of the Independent Intellectual*, in Samuels and Weiner, Eds., The Political Culture of Foreign Area and International Studies, Washington, DC: Brasseys, Inc., 1992, p.106.

2. Chalmers Johnson, MITI and the Japanese Miracle, Stanford: Stanford University Press, 1982.

3. These comments are based on a wide ranging conversation on revisionist thinking with Ron Morse, then Vice President of the Economic Strategy Institute, Washington, DC, February 28, 1991 (Morse, it should be noted, is not a subscriber to the "containing Japan" thesis).

4. Conversation with former USTR, Director for Japan -- and noted opponent of the SII process -- Glenn Fukushima, Tokyo, Japan, February 24, 1992. (Fukushima is now Director of Japan Market Strategy at AT&T in Tokyo.)

5. This comment was made to a group of reporters during Iacocca's visit to Japan accompanying then-President George Bush in January, 1992 (reported on Asahi- Japanese television, January 8, 1992).

6. *Iacocca Talks on What Ails Detroit*, Time, February 12, 1990, p.68. In Iacocca's words, "Chrysler went from zero to selling 50,000 cars in Europe last year, from zero to 5,700 cars in Taiwan, and zero to just zero in Japan. Now somebody should investigate that. There's a crook there someplace....How can they continue to shut us out year in and year out without a backlash. I'm not suggesting a real shooting war, but I'm suggesting a great wave of protectionism if they really level us."

7. For durable manufactures in 1990, the figure was 45%. See *Tsushou Hakusho* (MITI White Paper on Trade) TsuSan-sho: 1991, p.216.

8. From *Gaishi-Kei Kigyou Koudou Chousa*, Houjin Kigyou Toukei, MITI, 1991 and *Survey of Current Business*, US Department of Commerce, 1989.

9. Edward J. Lincoln, Japan's Unequal Trade, Washington: The Brookings Institution, 1990, p.40.

10. For a full discussion of how relationships effect business in Japan, again see our forthcoming companion piece -- *Insider Capitalism*.

11. The important role of external relations (*shougai katsudou*) in the world of Japanese business is thoroughly documented in Tokyo-based business consultant Keith Henry's study: *Shougai Katsudou and the Foreign Firm*, Sophia University, Institute of Comparative Culture, Tokyo, 1992.

12. See country by country trade performance tables in *The World Competitiveness Report*, Lausanne, Switzerland: IMD, 1992.

13. See *World Competitiveness Report*, p.29.

14. For a convincing argument that the capital costs of internationally competitive American firms are on par with most of their Japanese counterparts, see: W. Carl Kester and Timothy A. Luehman, "The Myth of Japan's Low-Cost Capital," *Harvard Business Review*, May-June 1992, pp.130-138.

15. "Strategic investment" used in this context might be defined as that which contributes to – rather than detracts from – product exports from home operations to subsidiaries and facilitates the maintenance at home of a corporations' international export competitive advantage . Harvard Business School Professor Dennis Encarnation uses this term in his extremely fine study of the effect of the US-Japan direct investment imbalance on the broader bi-lateral trade relationship. See Dennis Encarnation. *Rivals Beyond Trade: America Versus Japan in Global Competition*. Ithaca, New York: Cornell University Press, 1992. Mark Mason, a Professor at Yale University, has also made a significant contribution to our understanding of the foreign investment situation in Japan and its ramifications for US corporate competitiveness there. See Mark Mason. *American Multinationals in Japan: The Political Economy of Capital Controls*. Cambridge: Harvard Council on East Asian Studies, 1992. MITI's analysis of the positive relationship between investment and trade can be found in a number of documents. For example, "Tai-Nichi Toushi to Boeki ni tsuite" (Regarding Direct Investment and Trade in Japan), TsuTsanShou, Kokusai Kigyou-Ka (MITI- International Business Section), September 1991. The Keidanren findings are detailed in the report *Improvement of the Investment Climate and Promotion of Foreign Direct Investment*, October 27, 1992.

The Wednesday Group would like to sincerely thank Mr. Takato Ojimi, former Director of International Business at MITI, for his assistance in gathering data on the investment and trade activities of foreign businesses in Japan.

16. For descriptions of why maintaining subsidiary control is important, in addition to books by Mason and Encarnation *op.cit.*, see Norman Glickman and Douglas Woodward, The New Competitors: How Foreign Investors are Changing the U.S. Economy, New York: Basic Books, 1989, chapter on "Intangible Advantages and Direct Investment," pp.82-84.

17. Comment made to author during a meeting at Du Pont-Japan headquarters, December 17, 1992.

18. Encarnation, *op.cit.* p.29.

19. See "Measures for Promoting Foreign Direct Investment in Japan," MITI- International Business Section, January 1992, p.18.

20. In fact the Foreign Exchange and Foreign Trade Control Law was actually drafted by Jan V. Mladek of the Interntaional Monetary Fund at the invitation of the SCAP (Supreme Command for the Allied Occupation of Japan). See John Haley. "Administrative Guidance versus Formal Regulation," in Saxonhouse and Yamamura, Eds. Law and Trade Issues of the Japanese Economy, Tokyo: University of Tokyo Press, 1986, p.116.

21. Hashimoto Juro, "Sen Kyuu Hyaku Go-jyuu nen" (1955) in Yasuba Yasukichi and Inoki *Takenori. Koudou Seichou.* (High Speed Growth), Vol. 8 in the *Nihon Keizai-Shi* series, pp.88-89.

22 Hashimoto Juro, "Sen Kyuu Kyaku Go-jyuu nen" (1955) pp. 88-89.

23. Mason, *op. cit.*, p.155.

24. Hashimoto Juro, "Sen Kyuu Hyaku Go-jyuu nen" (1955), pp.88-89.

25. This view is very much in the mainstream today among Japan specialists. For example, see Murakami Yasusuke's article, "The Japanese Model of Political Economy," in the 'bible' of contemporary Japanese political economic study: The Political Economy of Japanese Relations, Stanford: Stanford University Press, 1987, p.49.

26. This remarkable explanation was provided to the author over dinner and drinks, Tokyo, January 19, 1993.

27. See Mason, *op. cit.* Chapter Four, *The Screen Door, 1950-70* for a complete description of GOJ investment restrictions and foreign responses. Also, see Encarnation, *op.cit.*, p.32.

28. Mason, *op.cit.*, p.157.

29. It should be noted that Chrysler also struggled to set up operations in Japan in the 1960s, although it was not there before the war.

30. The "rationale" for kicking foreign companies out of Japan following the Occupation and keeping them out through most of the first thirty-five years afterward was kindly explained to Wednesday Group staff by the Minister for Economic Affairs at the Japanese Embassy, Washington, DC, September 14, 1992.

31. Quoted in Mason, *op.cit.*, p.232. It should be noted that IBM had been already "allowed" back in Japan -- in exchange for accepting the right of Japanese government and industry to "supervise" its activities in the "free market" and for giving up control of its basic computer patents. In hindsight, in order to get access, it virtually was forced to create its major competition in the future.

32. Mason, *op.cit.*, pp.232-233. Ironically, the same justification was given to defend Japan's 26% tariff against right-hand-drive foreign car imports all the way until 1989. Japan today still has 10 domestic auto producers and no major foreign rivals in its home market.

33. Mason, *op.cit.*, pp. 236-237.

34. Interview conducted at GM-Japan headquarters, Tokyo, December 9, 1992.

35. From Mark Mason's American Multinationals and Japan: The Political Economy of Japanese Capital Controls 1899-1990, Cambridge: Council on East Asian Studies, Harvard University, 1992, p. 12. Reprinted here with the publisher's permission.

36. See Odaka Konousuke, "Seicho no Kiseki- 2" (The Remnants of Growth- 2) pp.154-208; particularly section called 'Katei Gomi' ('Household Trash'), pp.188-198 in *op.cit.* Koudou Seichou.

37. See Robert Cutts, "Power from the Ground Up: Japan's Land Bubble," *Harvard Business Review*, May-June, 1990, pp. 164 and 167.

38. The "never-ending cycle" was rooted ultimately in the faith of Japan's major trading partners that the "paper money" the Japanese money machine created at an astounding rate was actually worth something. Cutts wrote in 1990 that:

> Some years ago, Peter Drucker said prophetically that the business future belongs to those enterprises with the best access to capital. Japan is proving him correct. What neither he nor anyone else in America could foresee is that the Japanese would create their capital advantage by realizing a theory that every capitalist nation knows but no others have yet dared to act on for open advantage: money is only paper, with no intrinsic value other than what buyer and seller agree on....The real Japanese innovation came, as usual, in linking something old and familiar with something new and opportune: manipulation of the domestic land market and the global deregulation of capital markets. By claiming that their land is worth anything the buyers and sellers of credit claim it is, and by realizing that amount through the wide-open, cheap-money lending policies of the Ministry of Finance (and the securities markets where billions of dollars is pooled) Japanese corporations are making the theory work for them. (Cutts, *op.cit.*, p. 172.)

39. Interview with Japanese bank official, February 22, 1993. This gentleman reports that his bank alone made over 1,500 such loans in the late 1980s.

40. See *Trade and Investment in Japan: The Current Environment*, prepared for the American Chamber of Commerce in Japan by A.T. Kearney and Co. International, 1991, p.56 (see answer to survey question 37).

41. This comment was made to the author at an American Embassy-Tokyo reception in March, 1992.

42. For a fairly complete overview of foreign investment in Japan and that of Japan abroad see *Gaishi Kei Kigyou no Nihon Shijou De no Katsudou Joukyou.* (The Activities of Foreign Capital Corporations in the Japanese Market). *TsuTsanShou* (MITI), *Kokusai Kigyou Ka* (International Business Section), April, 1992.

43. In addition to the many works cited below in regard to land policy which also deal with the irrationality of the cost structure of the Japanese economy, see, for example, Shimada Haruo. *Nihon Keizai Mujun to Saisei.* (*The Japanese Economy: Contradictions and Revival*). Tokyo: Chikuma Shobou, 1991 especially "yutakasa o kangaeru:kinrousya seikatsu no kokusai hikaku and josetsu" ("Thinking of our wealth: a wage earners life--an international comparison and introductory remarks"), pp. 49-81 and the third section of the book, entitled "Nihon Seikou no Aironii" (The Irony of Japan's Success"), pp. 171-232. Indicative enough, a keyword that is used frequently books on Japan's cost structure like Shimada's is "waikyoku" or distortion (or sometimes the verb from which the "wai" part of it is derived: "hizumu"- to become crooked or bent out of shape). Also, see a fine study by Christopher Wood (The *Economist*'s Far East Financial Editor) The Bubble Economy New York: The Atlantic Monthly Press, 1992.

44. Yukio Noguchi, Tochi no Keizaigaku (*The Economics of the Japanese Land Problem*), Nihon Keizai Shimbun-Sha, 1989. In addition, research on Japan's land problem (*tochi mondai*) is voluminous. Stand-out works include: Yukio Noguchi's insightful reflection on the "bubble economy" and its ramifications for Japan, Baburu no Keizaigaku: Nihon Keizai ni Nani ga Okotta ka, (The Economics of the Bubble: What Happened to the Japanese Economy?), Nihon Keizai Shimbun-Sha, 1992; Tokunosuke Hasegawa's Tochi Kaikaku no Shiten (Viewpoints on Land Reform), Tokyo: Toyo Keizai Shinposha, 1990 provides important analysis of the central role of land tax policy on the misallocation and underutilization of precious land resources; also see, Shimada Haruo, Nihon Keizai Mujun to Saisei, especially the section entitled *tochi to kinyuu ga nihon* o *hizumeru* (*Land and finance have distorted Japan*), pp. 3-46. In English, a real tour de force effort is the group effort of a number of top Japan scholars, John Haley and Kozo Yamamura, Eds., Land Policy in Japan: A Policy Failure? Seattle: Society for Japanese Studies, 1992. The numerous fine reports on the state of land and stock speculation in the Japanese economy produced by the prescient UBS-Phillips Drew analyst, Christopher Rathke, also deserve mention as does the section plainly entitled *Land* in Wood, *op. cit.*

45. Noguchi, *Land Problems and Policies*, in Haley and Yamamura, Eds. *op.cit.*, p.30.

46. See "Sengo Saidai no Biru Busoku: Deguchi ga Mieru no wa hayukute 10 nen-go" ("The Biggest Shortage of [new] Building in the Post War Period: At the fastest it will be ten years before the exit appears"), *Shukan Toyo Keizai*, January 23, 1993, pp.6-20.

47. See *Improvement of the Investment Climate and Promotion of Foreign Direct Investment into Japan*, issued by Keidanren, October 27, 1992, p.16.

48 Sakakibara Eisuke, Shihonchugi o Koeta Nihon (The Japan that has Surpassed Capitalism), Tokyo, Toyo Keizai Shimbunsha, 1990. As Sakakibara, Deputy Director General in the International Finance Division of Japan's Ministry of Finance, puts it in this provocative book,

> What differentiates the Japanese model from others is the non-existence of capitalists in the system. Although the relative power of capitalists has been substantially eroded both in Europe and the United States since the Great Depression, Japan has gone to the extreme of eradicating the capitalist class as a whole...

49. Peter Drucker -- whose term this is -- also proposes that the US government adopt a new trade policy toward Japan emphasizing "reciprocity" (a major part of our suggested constructive engagement approach. See Drucker, The New Realities, New York: Harper and Row, 1989, pp.129-132.

About the Wednesday Group

The House Wednesday Group is a Republican organization founded in 1963 in the US House of Representatives. It provides a forum through which its Members discuss politics and policy, develop legislative proposals, and advance their knowledge on issues of shared concern.

The thirty-seven Wednesday Group Members, chosen by invitation and representing a diverse range of geographical and ideological backgrounds, meet every week to discuss their ideas. The Group, whose Chairman is Jim Kolbe of Arizona, is supported by a professional staff that arranges seminars with leaders in the policy community, conducts research for reports on major issues, and works with the Members to develop legislation.

Other ongoing Wednesday Group work includes welfare and health care reform projects. In October, 1991 the Group released a paper entitled *Moving Ahead: Initiatives for Expanding Opportunity in America* which identifies and discusses a number of social policy initiatives. In March, 1992 the Group released a paper entitled *Bridging the Gap: Health Care Coverage for Low-Income Families* which furthers the health care reform discussion in *Moving Ahead* and proposes a strategy for improving access to health care for the nation's poor. In July, 1992 the Group issued the paper *Primer on Medicaid Waivers, ERISA and State Health Initiatives*. This report is a primer on the Medicaid waiver process and the Employee Retirement Income Security Act as these regulations relate to state-based health care reform initiatives. In August, 1992 the Group released the report *New Directions: Welfare Reform in Twelve States*.

The views expressed in Beyond Revisionism do not necessarily reflect those of all Members of the House Wednesday Group.

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Chairman GIBBONS. Well, I appreciate your fine statement, David. Are there questions for Mr. Dreier?

Mr. MATSUI. I just would like to thank David for his testimony and for all the work he has been doing in this particular area and in other areas as well, such as NAFTA. I think that this framework agreement is a first step toward achieving the goal of more open trade between the two countries, and so we appreciate this. Thanks for your testimony.

Mr. DREIER. Thank you very much, Bob.

Chairman GIBBONS. Good.

Mr. SHAW. Mr. Chairman, very briefly, I do want to associate myself with Mr. Dreier's remarks. I think that the idea of thinking about a free trade agreement with Japan and bringing down many of the barriers, including procedural barriers which are continually being thrown in front of our producers, is a good one. I want to emphasize that we do have to go beyond just tariff barriers and get involved in the technical areas that are put in front of American producers who are working to introduce American products into the Japanese market.

Mr. DREIER. Well, Clay, you are absolutely right. Traditionally, negotiations in trade agreements have centered primarily on tariff issues, but we have found from the negotiations in the North American Free Trade Agreement and the side agreements that this process has expanded to other areas. and I am well aware that the keiretsu system and other cultural barriers create a difficulty for us, as does Japanese cost protectionism, and so my vision is to see us deal with those challenges as we would move ahead with the negotiations of the United States-Japan free trade agreement.

Mr. SHAW. Mr. Chairman, I think there is nothing that would be better for the American economy or for the Japanese consumers than to be able to free up trade on both sides and to really get down to a free market and perhaps even a free trade agreement. Thank you, Mr. Chairman.

Chairman GIBBONS. Thank you.

Mr. DREIER. Mr. Chairman, I hope I have been able to help get you back on schedule almost as much as if I hadn't shown up.

Chairman GIBBONS. Well, no, we're glad to have you testify. Thank you very much.

Mr. C. Fred Bergsten, who is the managing director for the Institute for International Economics, an old friend of this committee, and one who has come here often to advise us.

STATEMENT OF C. FRED BERGSTEN, DIRECTOR, INSTITUTE FOR INTERNATIONAL ECONOMICS

Mr. BERGSTEN. Thank you very much, Mr. Chairman. It is great to see all of you again. I know your time is tight, so I will just summarize briefly some of the remarks that are in the prepared statement that I have given to you this morning. Before I address the United States-Japan arrangement, I want to join in the congratulations to Ambassador Kantor and the administration for their success last week. I think this was the most successful economic summit meeting in 15 years.

Chairman GIBBONS. Good.

Mr. BERGSTEN. Now that is not saying too much because some of the summits in the last 10 years or so have not done very much at all.

Chairman GIBBONS. But we are improving anyway.

Mr. BERGSTEN. But I think it was quite a positive accomplishment. The last one in this league was the Bonn summit of 1978, which you may remember broke the deadlock in the Tokyo round of trade negotiations. Bob Strauss always said that had it not been for the intervention of the G–7 summit in 1978 in Bonn, the Tokyo round would never have come to a successful outcome. I think what was done in Tokyo this time to advance the Uruguay round has an equivalently important impact, and for that and several other reasons I would say this was the best summit in 15 years. I hope you will address those issues soon. I am sure you will.

I said in a speech in January that the G–7 is dead but it has to be revived, and I think this summit in Tokyo has gone a long way toward doing that. On the United States-Japan issue, which is today's topic, your focus is trade policy, and I want to spend most of my time on that. I do want to say one word at the outset on the macroeconomic picture, specifically the trade balances. The Japanese global current account surplus is a big global economic problem. Japan is the only country in the G–7 running a surplus, and it is the only country in the world now running a large and growing trade and current account surplus. The situation is the reverse of what it was back in the mid-1980s when Japan had its last big surplus. At that time the United States was running a massive deficit and everybody else was in surplus. It was clearly an American problem. Our dollar was overvalued; our budget deficit was soaring. It was our problem. We had to initiate and take the bulk of the corrective action.

This is no longer the case. We still have a deficit but it is much lower. It is not rising very much. It is only about 1 percent of our GNP. We still have a lot of work to do, but the Japanese surplus now stands out like a sore thumb. It therefore is the central problem to be addressed.

Part of the solution lies within the realm of trade policy, and I will come back to this in a moment. But the one comforting aspect of the Japanese surplus problem is we know what causes it and we know what to do about it. There are basically two causes. One is the domestic recession in Japan. Japan's domestic demand has been flat or declining for 2 years. Their imports have dropped; they have got to get their economy growing again through domestic demand expansion in order to begin again importing and bringing down their surplus.

Second and most important, and I have talked to you frequently on this topic, is the exchange rate of the yen. The exchange rate of the yen has a powerful effect. My and Marcus Nolan's new book, which has already been referred to here several times, shows that every 1 percent change in the exchange rate of the yen changes the Japanese global current account balance by $4 to $5 billion a year after a lag of 2 years. In other words, if the yen declines 10 percent, which is not very much the way the financial markets move these days, it will improve Japan's global surplus by $40 billion 2 years down the road.

We know that is right because in the late 1980s, as you will recall, the Japanese global current account surplus came down from 4.3 percent of their GNP in 1986 to 1.2 percent in 1990. The problem wasn't totally solved but it was enormously reduced through a domestic demand boom in Japan from 1987 to 1990 and a doubling of the value of the exchange rate of the yen. The surplus has risen again because both domestic demand and the exchange rate are out of whack. Japan has been in domestic recession for over 2 years, and the exchange rate of the yen dropped 25 to 30 percent in 1989 and 1990 despite the continued improvement in Japan's underlying competitive position. We predicted in 1990 that the Japanese surplus was going to soar again, and 2 years later it has done so.

The remedies are also clear. Japan must raise its domestic demand growth to at least 4 percent a year through fiscal stimulus. Fortunately, they can do it, unlike us, because they have a budget surplus equal to 3 percent of their GNP. The other remedy is to make sure that the yen stays at the current level of about 110 yen to the dollar. I would be a little more comfortable if the yen rose a little bit more, to about 100 to 1 against the dollar, but no one can be that precise. It is in the right zone.

The crucial issue now for the U.S. Treasury and the G–7 is to make sure the yen does not weaken again before the corrective effect plays through. They now ought to be installing a system of target zones to maintain the current exchange rate. At a minimum they ought to go back to the reference ranges the G–7 did put in place in 1987 and 1988 but then dropped as they let the yen weaken again. The crucial policy tool now to bring down the huge Japanese surplus is to make sure the yen stays strong.

The models shown in our book, which have been very accurate, suggest that if you keep the yen even at 110:1 and if Japan boosts its domestic growth rate to 4 percent, the administration's minimum target will be achieved; namely, bringing the Japanese global surplus down to 2 percent of their GNP. If you want to take it down to 1½ or 1 percent, the yen must rise to something like 100 to the dollar, and the surplus will drop, probably by 1995 and certainly by 1996. The biggest bang for the buck on the overall surplus is in the exchange rates and the domestic growth rates in Japan, and they ought to be major targets of administration policy.

The administration has basically done the right things. It pushed Japan to stimulate the domestic economy. It pushed the yen up, despite sometimes denying it has done so, but now it is crucial to keep it there, and I hope you will weigh in to insist that they do.

Having said that, I must also say that macroeconomic measures, of course, are not enough. Our new book, already referenced both by Ambassador Kantor and Congressman Hoagland, analyzed in some depth a dozen key sectors that range across the entire Japanese economy—agriculture, high tech manufacturing, medium tech manufacturing, financial services, and some other services. The picture that emerges from our careful analysis of this wide range of industries is of a very exclusionary, restrictive Japanese economy that pervasively combines exclusionary corporate practices with governmental intervention and regulation. Some of that governmental intervention has, in fact, disappeared and been liberalized,

but the legacy of the past interaction between tight government regulation and exclusionary corporate business practices effectively shuts out outsiders; in many cases outsider Japanese firms, but certainly foreign ones as well.

Our bottom line, already referenced, was that Japanese barriers block out U.S. exports on the order of $9 billion to $18 billion per year. That is probably a conservative estimate, for two reasons. First, we were not able to involve in that estimate all of the services sector. Our estimate is comprehensive on agriculture, and we think comprehensive on manufacturing. It brings in some services, but not, for instance, the insurance industry, which alone might generate an extra billion dollars or so of profits for American firms if it were liberalized.

The second reason our number is probably low is the fact that most past estimates of the effect of Japanese liberalization have undershot. In our book we looked into the past at contemporary estimates of the potential payoff in terms of U.S. export expansion if Japan liberalized. In many cases the contemporary estimates were way too low. In the case of cigarettes, for example, the contemporary estimates were one-tenth of the expansion that in fact occurred. In beef and citrus the contemporary estimates were half or less of the actual outcome. In other words, once you liberalized the Japanese market, Japanese consumers go after the product, and we just can't tell from the relationships that exist in a controlled market what might actually happen in an open market. That is, incidentally, one of the risks with setting quantitative targets for our exports to Japan: We will probably set the number too low because most contemporary estimates do tend to come in on the low side.

In any event, our study shows there is a lot of mileage to be gained from opening Japan's markets and increasing access. I hasten to add, because Ambassador Kantor misspoke in one sense, that even if you got rid of all those barriers, our net trade balance probably would not improve by the full $9 to $18 billion. There would be some offsets. The increased imports, for example, would improve Japan's competitiveness further. If the Japanese took advantage of lower cost imported components for their products, they would become more competitive, and they would sell more of some other products. The exchange rate would also tend to adjust to some extent, so the net gain would not be quite as big. We estimate it would be roughly half as much, but such a gain would be substantial, and, of course, it is critical to the individual sectors and for our economy as a whole to reduce or eliminate those market access barriers in the course of upcoming negotiations.

I think the central question in these negotiations will be the managed trade aspect. The administration has been criticized for trying to "manage trade," implying it is a terrible thing, and some people in reviewing my new book have said, "Bergsten seems to have gone the way of the managed traders. We thought he was a free trader, but he has been converted." Some like the idea; some don't like it. But in fact, there has been no conversion at all.

The important point to keep in mind is that the term "managed trade" is not synonymous with protectionism, and the two things can be extremely different. As I understand it, what the adminis-

tration means by quantitative targets, measurable indicators and the like has nothing to do with protectionism. They are not talking about reducing access to the American market or raising new barriers. They are talking, as are we in our book, about increasing penetration of the Japanese market. That means increasing levels of trade, getting more firms into the market, reducing concentration in that market, reducing prices, and increasing the quality and availability of goods. It seems to me that is what free trade and market economics are all about.

Our book suggests that there are unusual types of restrictions in the Japanese market to which you may have to respond with unorthodox techniques. Some call it managed trade. I think Larry Summers coined a very apt phrase. He said we are not trying to manage trade with Japan; we are trying to unmanage trade. We are trying to get them to undo their market access limitations in a way that would permit trade to expand, increase the number of participants in the Japanese market in these sectors and therefore simulate market outcomes. As a market-oriented, free-trade-oriented economist, I come out in exactly the same place in my book.

Obviously you have to be very careful how you do it. In the book we point to some practical problems with these import expansion agreements or quantitative indicators. As I mentioned, any number is going to be arbitrary, and you may undershoot. You may set a ceiling instead of a floor if you are not careful. If you set a number, whether you call it a benchmark or a criterion or a target or a commitment, you can't control the outcome, and you better enter negotiations knowing that. Technology changes, market demand changes, the exchange rate changes, and growth rates change. Suppose that you set a target and don't meet it. Then the United States will face pressure to retaliate because the Japanese didn't meet the goal, even if they didn't meet it for some reason completely outside their control. But if you don't retaliate, then you are viewed as going soft and not carrying out a tough position, and that undermines you the next time around.

In short, when you set these goals, indicators and quantitative measures, you set up a potential dynamic that can come back to bite you. You have to be very careful. You set precedents, of course, that could also come back to bite you, and you risk what the political scientists call political capture, particularly in our system, and you on the committee know this better than anybody.

Suppose you decide to go after specific markets with quantitative targets Which markets do you go after? How do you decide? What products? What sectors? What industries? In our book we went through a number of sectors and tried to make some rough estimates of the potential payoff, and a table of those estimates from our book is, in fact, attached to the end of my statement. We suggest that in mainframe computers, for example, you might be able to get more than a billion dollars of additional sales from real liberalization in Japan. In supercomputers if you got $30 million, you would probably be lucky. We are talking about a range of 30 to 40 times as much in one sector as in another. In some of the past instances that we estimate, on the left side of that table attached to my testimony, there was a payoff of a billion dollars or more, in others half a billion dollars, in some $30 to $40 million. So when

you are deciding which sectors to pursue, you have to do a very careful analysis of the potential payoff to rank your priorities. You have to see how big the market is now, how fast it is likely to grow, what the externalities are, the spinoffs for the American economy, and what the value added is in the United States.

If you import 80 percent of the final product and only get a value added of 20 percent, it is not worth pursuing, at least not to the same degree as you pursue other markets. In the book we try to set out criteria for selecting markets, and I would also commend that to your attention and that of the administration.

Finally, I come up with several thoughts in assessing what the administration has done so far. First, I basically support it. Our analysis basically supports the combination of seeking macroeconomic changes and changes in structural and sector-specific terms. Second, we caution against targeting the bilateral trade balance. The administration has been careful to say that it wants to bring down Japan's global current account surplus, which is absolutely right for the reasons I mentioned. But be careful not to confuse that with targeting the bilateral trade deficit. There are both practical and conceptual reasons for not targeting the bilateral deficit. Practically, we don't want the Europeans or Mexicans to demand that we eliminate our surpluses with them. The notion of bilateral balancing doesn't make sense in a multilateral trading world.

Pragmatically we show in our study that even if the United States achieved a zero global balance in its current account and even if Japan dropped to a zero balance in its global position, there would still be a significant bilateral Japanese surplus with the United States because of the pattern of trade between the two countries. Japan imports huge amounts of primary products from Saudi Arabia, Brazil, Australia, and the like. Even if Japan were running a zero balance, it would have to finance that balance by exporting manufactured goods to the United States, Western Europe, and other high-income industrial countries.

The bilateral number certainly ought to be a lot lower, and it will fall as the global imbalances fall, but targeting a bilateral trade balance of zero would be both futile and unnecessary.

Third, just to reiterate, the administration must lock in the stronger exchange rate for the yen to bring these imbalances down. That, incidentally, as another of the charts I have attached to my statement shows, will have a very significant effect in bringing down our bilateral deficit with Japan.

Fourth, and here I disagree with Ambassador Kantor on an important nuance, we conclude that structural issues are so important and such a source of potential benefit over time that they should be addressed separately, not lumped in with the sectoral discussions. He is certainly right to say tat structural and sectoral issues interact. You can't address one without the other, but the structural issues are so important that we believe a new round of talks on those alone—we call them the structural convergence talks, in which you would aim for convergence over time to some extent between the two economies—would make a lot of sense and should be part of the negotiating effort.

Finally, I have a recommendation to the Congress. Do not legislate on this issue. There is no need to do so, certainly not at this time. The administration has all the necessary authorities. It seems to me it is pursuing them aggressively and effectively. I don't see any need for legislation. It could, in fact, complicate the issue. You obviously reserve it as a possibility, but I think at this point the kind of monitoring you are doing today is right on track. Thank you very much.

Chairman GIBBONS. Well, thank you, Mr. Bergsten.

[A book submitted by Mr. Bergsten is being retained in the committee files.]

[The prepared statement and attachments follow:]

UNITED STATES-JAPAN ECONOMIC RELATIONS

A Statement by

C. Fred Bergsten
Director
Institute for International Economics

Before the
Subcommittee on Trade
Committee on Ways and Means

US House of Representatives

July 13, 1993

The Problem

My comprehensive new analysis, *Reconcilable Differences? United States-Japan Economic Conflict*,[1] divides the United States-Japan economic problem into four major components:

- Japan's large and growing global current account surplus (perhaps $150 billion in 1993), which effectively exports unemployment to other countries because it (1) occurs in a world of slow economic growth and (2) is due importantly to the stagnation of domestic demand in Japan itself;

- Japan's barriers to imports, which we estimate as blocking sales of $9-18 billion from the United States alone (of which about one third are in agriculture with most of the rest in manufacturing);

- significant structural differences between the two economies; and

- the failure of these two largest economies in the world, along with the integrating EC, to provide effective collective leadership of the world economy.

All four of these problems must be addressed urgently and effectively. By far the largest payoff comes from macroeconomic policy changes:

- every 1 percent appreciation of the yen, after two years, cuts Japan's global surplus by $4 billion and its bilateral surplus with the United States by $1 billion (see attached Figures 2.2 and 2.3);

- every 1 percent per year increase in Japan's economic growth rate cuts its global surplus by $4-5 billion with very little lag.

We know that these measure work effectively because they did so in the second half of the 1980s. After the yen doubled in value during 1985-87 and Japan launched an expansionary domestic demand policy,[2] Japan's global current account surplus fell from

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[1] Published by the Institute for International Economics and co-authored with Marcus Noland, who was a Research Fellow at the Institute for International Economics while the book was being written and is now a Senior Economist at the Council of Economic Advisers.

[2] That policy produced the so-called "bubble" economy because it relied excessively on easy monetary policy and never included much fiscal stimulus. The problem was not the effort to expand

4.3 percent of its GDP in 1986 to 1.2 percent in 1990. America's global current account deficit correspondingly fell from 3.7 percent of our GDP in 1987 to under 1 percent in 1991 (even excluding our receipts from allies to help finance the Persian Gulf war).

Japan's global surplus has now soared because these two key variables were again permitted to get out of line. Japan burst the "bubble economy" with tight monetary policy and has thus suffered from slow growth in domestic demand since 1991--turning it back to reliance on export-led growth. That was in turn possible because the yen weakened by 25-30 percent in 1989-90 despite continued steady improvement in Japan's underlying competitive position. In textbook fashion--and as my colleagues at the Institute for International Economics and I predicted at the time--Japan's surplus began to soar two years later. Most of the blame for the inappropriate weakening of the yen, incidentally, lies not with the Japanese but with (1) the markets for ignoring the underlying fundamentals of the Japanese economy and (2) the US Treasury and the G-7, which went to sleep at the switch and let it happen.

It is clear how Japan can correct its global surplus: restore domestic demand growth to at least 4 percent annually through expansionary fiscal policy, taking advantage of the fact that its budget surplus remains at 3 percent of its GDP, and work with its G-7 partners to make sure that the yen remains at the much stronger level to which it has risen over the past six months.[3] If sustained around current levels, the recent yen appreciation guarantees a sharp fall in Japan's surplus by 1995-96--bringing it within the Administration's goal of 1-2 percent of Japan's GDP. Hence the Administration's major initiative in this area should be an effort to achieve Japanese (or, better, G-7) agreement to a system of target zones (or its weaker variant of reference ranges as adopted by the G-7 in the Louvre Accord in 1987 and maintained for a time thereafter) that would prevent renewed weakening of the yen.

Trade Policy Initiatives

Macroeconomic measures are not enough, however. Our new book analyzes in some depth a dozen sectors that range across the entire Japanese economy: in agriculture, high-tech manufacturing, medium tech manufacturing, financial services, and some other services. The picture that emerges is of a very exclusionary, restrictive economy that pervasively combines exclusionary corporate practices (including but ranging well beyond the famous *keiretsu*) with governmental intervention and regulation (some of which has now disappeared but leaves a legacy that makes penetration by outsiders--outsider Japanese as well as foreigners--extremely difficult.

Some of these problems are structural in the sense that they cut across a number of sectors. Japan is clearly a "different"

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domestic demand but the policy mix which was pursued, notably the stubborn opposition of Japan's Ministry of Finance to expansionary fiscal policy even though the country is running a large budget surplus.

[3] It is comforting from an American standpoint to note that the yen (and, to a minor degree, the Swiss franc) are the only currencies against which the dollar has declined over the past six or twelve months. The trade-weighted average of the dollar has risen over both periods.

economy in many respects. However, Japan is also changing very rapidly and convergence between our two economies--some in the direction of Japanese practices, some in the direction of our practices, some toward intermediate outcomes--is already occurring. Policy changes can accelerate this process and we recommend a new series of Structural Convergence Talks (SCT) that would be directed to the objective.

In addition, however, it will be necessary to address a number of the specific barriers on a sector-by-sector basis.[4] The key here is for the Administration to make a careful assessment of the potential payoff from among the wide range of potential candidates; our illustrative analysis (Table 5.5) suggests that a meaningful deal on mainframe computers, for example, would be worth 35 times as much as a deal on supercomputers. Past negotiating agendas have been determined too frequently instead via the "squeaky wheel" principle, i.e., the industries that complained the most got the most attention whether or not the likely benefits to the economy were substantial.

Having selected which sectors to pursue, the second key issue is how to pursue them. The preferred course is always to seek elimination of a specific government policy that limits imports, such as public procurement in the cases of construction contracting or supercomputers. If the problem is exclusionary practices among Japanese firms, the proper remedy is antitrust policy.

When neither of the preferred options is available and it can be demonstrated persuasively that access to a Japanese market is artificially hindered, it may be necessary to seek Japanese agreement to temporary use of quantitative measures of increased penetration--to manage the trade in a way that will unmanage the market. I have no philosophical problem with such efforts: they expand trade, expand the number of participants in the targeted market, increase competition, reduce prices and reduce cartel activity. They bear no resemblance to traditional protection--which closes markets, reduces the availability of the product, raises prices and creates or shores up cartels. There would certainly be nothing new in "managed trade" (of either variety): the Reagan and Bush Administrations forced Japan to accept "voluntary export restraints" (VERs) on its sales to the United States of automobiles, steel and machine tools, and quantitative import targets on semiconductors, autos and auto parts.

However, there are major practical problems with quantitative market target industries ("involuntary import expansion" arrangements, or IIEs). First, any numerical goal (like the 20 percent market share for semiconductors) is bound to be arbitrary. Moreover, our negotiators may well shoot too low--the analysis of several sectors in our book shows that the actual impact of market liberalization was far higher than anyone anticipated at that time. Second, no government can control the outcome--and hence the "success" or "failure" of the agreement, including the implications for retaliation, are also arbitrary. Third, a policy that relies on such devices is inherently subject to political capture, i.e., the "squeaky wheel" syndrome, in both the exporting and importing countries. Fourth, precedents are set and the initiator of the idea could at some future point easily become its target.

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[4] Unlike the situation in the early and middle 1980s, when the United States persuaded Japan to restrict its exports of automobiles and steel to the United States, there are now no significant US barriers to Japanese exports.

Having said all that, we endorse "IIEs" if no other policy tool is available and the sector is sufficiently important. But they should be used sparingly. Their deployment should always be temporary. They should be used to expand trade (IIEs) rather than to reduce trade (VERs). They should apply to imports from all countries rather than just the United States. Every effort should be made to find superior alternatives in each individual case.

In its current negotiations with Japan, the Administration has clearly stated that the "quantitative indicators" that it has in mind are not limited to IIEs (or any other type of benchmark). Our study of the various sectors suggests that a case-by-case approach will be necessary, tailoring the criteria against which to judge "success" to the nature of each individual sector. I suspect this will in fact be the most difficult and most critical aspect of the talks when they finally begin in earnest by addressing specific sectors, but that solutions can ultimately be found that both countries can accept.

An Assessment of the Administration's Effort

Our new study thus largely supports the basic thrust of the Administration's Japan policy to date: pressing the Japanese to boost domestic demand through expansionary fiscal policy, a stronger yen, support for global trade liberalization through the Uruguay Round in the GATT, and sector-specific liberalization including through structural changes that will open the Japanese economy increasingly to external trade and investment. In the course of implementing this policy, I would suggest four modifications in the present strategy.

First, the Administration has been quite explicit about the nature of the macroeconomic commitment it has sought from Japan: a sharp cut in that country's global current account surplus. In its daily rhetoric, however, Administration officials have often spoken of seeking significant cuts in--or even elimination of--Japan's bilateral trade surplus with the United States. These are two very different policy targets and the Administration should carefully focus its attention on the former.

Targeting the bilateral trade imbalance makes no sense either conceptually or pragmatically. In a world of multilateral trade, it would be ridiculous to target bilateral balance with any country. We would be decidedly unhappy if the European Community or Mexico adopted a policy of eliminating their bilateral deficits with us.

Moreover, Japan will still run a sizable bilateral trade surplus with the United States even when it fully meets the Administration's target of cutting its global current account surplus to 1-2 percent of its GDP. There would still be such a bilateral imbalance if the United States fully eliminated its global current account deficit. The reason is the geographical pattern of trade: Japan imports huge amounts of primary products from Saudi Arabia, Australia and Brazil and must export similarly huge amounts of manufactured products to high-income industrial countries like the United States.

The bilateral imbalance has in fact been relatively stable: Japan's global surplus has quadrupled over the past three years (more than $100 billion) but its bilateral surplus with us has risen by "only" about 25 percent ($10 billion). The bilateral imbalance will clearly come down as Japan's global surplus declines, per the close linkage with the exchange rate as shown in Figure 2.3, especially as a share of both countries' economies and of the trade flows between them. It will remain sizable in absolute dollar terms, however, and we should not regard that as a major problem. The Administration should recognize this clearly and thus devote its full attention, rhetorically as well

as in practice, to reducing both countries' global current account imbalances.

Second, the Administration must recognize that some past negotiations with Japan have yielded impressive results. As noted, the Plaza-Louvre period of macroeconomic and currency coordination in 1985-87 brought an enormous reduction of the Japanese surplus and the American deficit. Our Table 5.5 shows that a number of past sectoral negotiations have generated impressive increases in American exports; the semiconductor deal, for example, appears to have doubled both US exports to Japan and the sales there of American-based firms from all of their production locations around the world. There has been encouraging progress on a number of the structural issues, such as Japan's distribution system (where large-scale American retailers are now expanding rapidly) and its willingness to use antitrust law (as in the recent egregious case of the glass industry).

Our book demonstrates that enormous problems remain in the United States-Japan economic relationship. Vigorous efforts across a wide range of issues are essential to deal with them. But it would be foolish to ignore the positive results of many past efforts and to fail to learn the lessons which they provide for the current effort.

Third, as already noted, the structural issues are so important, and the prospects for further convergence are sufficiently promising, that the Administration should pursue those issues separately from their sector-specific efforts. To be sure, these two sets of issues intersect; structural issues are an important component of some sectoral problems and some sectors cannot be opened without structural reform. But there is a risk that the structural matters may receive short shrift in a sector-focused approach, which would be extremely unfortunate because they offer such a promising prospect for improving the overall situation over time.

The Bush Administration's Structural Impediments Initiative (SII) made an important contribution to furthering the process of policy harmonization and performance convergence. Now that an American Administration is willing to take seriously the need for structural reform in this country, the prospects for success in such talks will be even greater. They should be rechristened the Structural Convergence Talks (SCT) and pursued on an independent track in the upcoming negotiations.

Fourth, as also noted above, the Treasury needs to lock in the stronger yen by getting Japan (and hopefully the entire G-7) to promptly implement a system of target zones around current exchange-rate levels.[5] Further yen appreciation to about 100:1 against the dollar would be desirable to assure the needed adjustment of Japan's current account. The Treasury's own target of reducing the Japanese surplus to 1-2 percent of its GDP in fact implies a target zone for the yen of about 100:1 to 110:1.

The most important goal now, however, is to avoid any significant renewed weakening of the yen. Such weakening has occurred on three previous occasions over the past twenty years--in 1975-76, 1980-82 and 1989-90--and triggered huge increases in Japan's surplus which in turn greatly intensified our trade problems and the frictions between the two countries. We should

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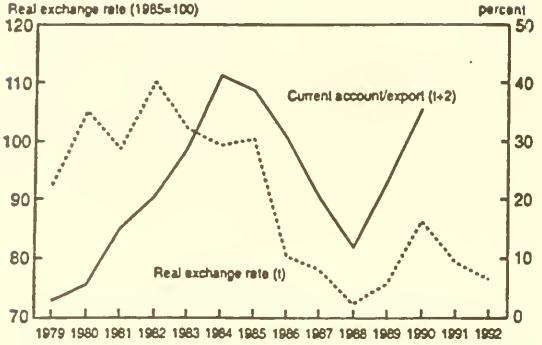
[5] The installation of reference ranges, a weaker version of target zones, by the G-7 in February 1987 was presaged by a bilateral United States-Japan agreement to set such a range for the yen-dollar in October 1986.

learn from history and avoid yet another replication of this sad history. Rapid installation of target zones is the most effective way to do so.

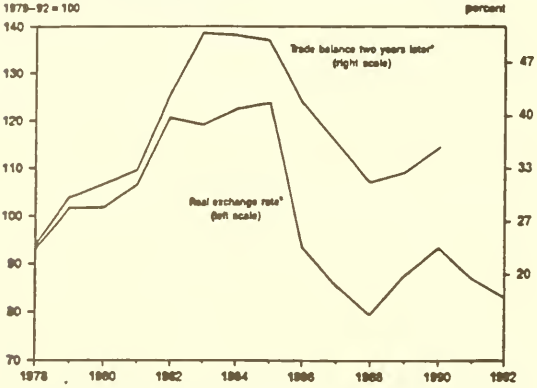
I would close with one word of advice for the Congress: do not legislate on this issue. It will take an enormous effort and an extended period of time for the Administration to achieve its objectives with Japan, as largely endorsed by our new study. Legislation of precise negotiating goals, time deadlines or retaliation requirements could convert a difficult task into an impossible one. The Administration has full authority under current law to pursue the talks and back them up with forceful action as necessary, and I hope that the Congress will restrain itself as the Administration uses these authorities to the fullest.

Figure 2.2 Japan: current account and real exchange rate



Source: International Monetary Fund, *International Financial Statistics*, various issues.

Figure 2.3 United States and Japan: real dollar-yen exchange rates and bilateral trade balances, 1978–92



a. US–Japan bilateral balance as a share of total US–Japan trade.
b. Yen-dollar rate adjusted for inflation in both countries.

Source: calculations by William R. Cline from International Monetary Fund data in *International Financial Statistics* and *Direction of Trade Statistics*, various issues.

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Table 5.5 Apparent and potential US gains from liberalization in Japan (millions of dollars)

Apparent gains from liberalizations implemented to date		Potential gains from future liberalizations	
Cigarettes	1,200	Computers[a]	1,075
Beef	500	Fuels	789
Semiconductors[b]	≤415	Wood products	750
Citrus	100	Retailing[c]	150
Fiber optics	33	Supercomputers	30

a. Does not include an estimated $1 billion in US firms' foreign-sourced products.
b. Does not include an estimated $715 million in US firms' foreign-sourced products.
c. Includes gains attributable to Toys 'R' Us only.

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Chairman GIBBONS. Let me ask you a couple of questions here. Let's go to those exhibits that you attached to your testimony, figures 2.2 and 2.3. I have to admit that I tried to study your book last night, but there were just too many other things that had to be accomplished and read. Could you explain that figure 2.2 chart?

Mr. BERGSTEN. What this chart says is that Japan's global current account balance—the solid line—tracks almost precisely, with a 2-year lag, the trade-weighted exchange rate of the yen—the dotted line. Japan's global trade outcome corresponds almost perfectly to Japan's global exchange rate 2 years before.

In the first few years of the 1980s, the chart, on the left scale, shows a period when the yen exchange rate was declining. The way the index works, a rising line means a declining value of the yen—a rising dollar. From 1979 to 1982, the yen declined significantly. That is the rising dotted line. And, with a 2-year lag, Japan's global current account surplus rose correspondingly. It rose a little longer in that time phase, a year or two longer than expected, due mainly to the enormous fall in world oil prices, but then changed direction. The exchange rate of the yen began to rise from 1982, and it rose sharply from 1985 through 1988. That was the period of the Plaza Agreement, the effort to bring down the dollar and to increase the value of the yen, the deutsche mark and other currencies. So from 1982 to 1988 the exchange rate of the yen rose substantially. That is the declining dotted line. With the 2-year lag, the black solid line, which is Japan's global current account surplus 2 years later, also declined sharply. That is measured on the right hand scale. If you want to put it in terms of Japan's GNP, the surplus dropped from 4.3 percent of GNP in 1986 to 1.2 percent in 1990.

This chart shows the surplus as a share of Japan's total trade. It dropped from 40 percent of its exports to a little over 10 percent of its exports in that 4-year period.

Then from 1988 to 1990 the exchange rate of the yen declined again, represented here by a rise in the dotted line. That decline in the value of the yen was not nearly as great as in the earlier period but it was substantial. It was about 25 percent from its base in 1988. With the 2-year lag, the solid line then turned up again, and that is the substantial increase in Japan's global surplus that we are now experiencing.

From about 1991, the dotted line turns down again. That means the exchange rate of the yen began to rise and so our prediction would be that, starting next year, Japan's trade surplus with the world would again start to decrease. I said before, that crucially depends on keeping the yen at the strong level it has now reached.

I hope that clarifies the relationship. It is not the easiest correlation to understand. We tried to put it in the simplest way possible.

Chairman GIBBONS. Well, is the correlation between the yen and the dollar approximately the same as the yen and the rest of the world currencies?

Mr. BERGSTEN. Not always. There have been periods, as in the early 1980s, when the yen went one direction against the dollar and the deutsche mark went the other direction. In the last 6 months or so, movements have again been in different directions. The yen has gone up very substantially against the dollar but the

dollar has gone up very substantially against the deutsche mark and the European currencies. In fact, I am getting a little worried that the dollar might now be getting a little too strong against the European currencies. I have not had that worry for some time.

It is interesting to note that the trade-weighted average of the dollar is not down over the last 6 months to a year; it is up. The dollar has declined only against the yen and, by a very modest amount, against the Swiss franc. The dollar has gone up considerably against the deutsche mark and most of the other European continental currencies. The dollar has gone up dramatically against the pound sterling, the Italian lira, and the other European currencies that were devalued within the European exchange rate system.

So the trade-weighted dollar is actually up quite substantially over the last 6 to 12 months. Newspaper reports of declining dollar are wrong. They mistake the fact that the yen has been rising for a dollar decline whereas, in fact, the dollar is up against the other major currencies.

What that means, of course, is that the yen has risen considerably against the dollar but it has risen much more against the European currencies, so the global average exchange rate of the yen in this period has gone up by much more than it has just against the dollar. This means that Japan's global surplus should decline even more than its bilateral surplus against the United States, based on the kind of relationships we are talking about.

Chairman GIBBONS. Well, as I remember when we began this discussion some years ago on the United States-Japan relationship, the yen was about 360 to the dollar. Is that about right?

Mr. BERGSTEN. Before the Smithsonian Agreement of 1971, over 20 years ago, the yen had been at 360 since the time we set that rate during the occupation.

Chairman GIBBONS. And this morning it was 110 to the dollar. How in the world do the Japanese still maintain this huge trade surplus with us with that kind of long-term swing in the exchange rate?

Mr. BERGSTEN. By being very competitive and by the fact that the 360 rate had become enormously undervalued by the time it finally was changed.

You may remember that Japan came on the world scene in a major way in trade in the 1960s and began to run substantial surpluses for the first time in the late 1960s. That was one of the main triggers for the first big set of exchange rate changes back in 1971 and 1973 but that change, though it seemed big at the time, only began to catch up with the enormous growth of Japan's productivity during the first generation of its postwar recovery. So subsequent further strengthenings of the yen were required.

I think that toward the end of 1987 we had it about right. At the end of 1987 the yen hit about 120 to 1 against the dollar, and with the usual lag Japan's global current account surplus was down to 1.2 percent of its GNP. Japan's bilateral surplus with the United States was still large in absolute terms, about $40 billion, but it had come down substantially as well.

If that exchange rate had been maintained, I don't think we would have this big Japanese surplus today or anything like it.

But, as I mentioned, the yen was permitted to weaken again by 25 or 30 percent, returning to 160:1, and that was a big factor in generating these surpluses.

You raised the question, with the yen at 360 then and at 110 now, and how could it be that Japan still has such a big surplus? It is simply the difference in productivity growth. Japan's productivity was growing at 10 to 12 percent a year all through the 1960s and into the early 1970s when ours was growing—better than today's standards—by 2 to 3 percent. And then subsequently they were growing at 4, 5, and 6 percent when we were growing at 1 or 2 percent. Those enormous differences in productivity growth, compounded over 25 or 30 years, simply require a big change in the exchange rate in order to equate the competitive positions.

Put another way, Japan has reaped a large part of the benefit from its enormous productivity expansion through a stronger currency, meaning it can buy things from foreigners and invest abroad at much less cost than it ever could in earlier periods.

Chairman GIBBONS. Bob.

Mr. MATSUI. Thank you, Mr. Chairman.

Fred, thank you very much for your testimony.

One of the fears I think many of us have is that the Japanese will attempt, as they have in the past, to delay negotiations while continuing to talk about the process. I think we feel confident that the Ambassador, USTR, the President, and others entered into a very good agreement, provided that everybody acts in good faith, but you have a change of government coming next week and who knows what might happen. And, again, I thought that Wall Street Journal piece was somewhat revealing when MITI and then the foreign ministers' deputies began to negotiate and then became angered with each other. Usually MITI ends up making the determinative decisions in many cases on those kinds of disputes, particularly if the Government is weakened.

What do you think we should do if Ambassador Kantor misses the deadline? Obviously, we are going to be very unhappy with that in the House and Senate.

I agree with you that we shouldn't legislate, particularly since we have a President who is serious about opening up the Japanese markets. And I agree with you also that we are talking about $9 to $15 billion. We are not talking about $40 billion. We are talking about a significant amount but small in terms of the overall trade surplus that the Japanese have, but it is enough to create a real major problem for all of us. And so we really have to deal with it.

What happens if there is no progress in trying to define what objective criteria is?

Mr. BERGSTEN. I think you must keep open the possibility of retaliation. You can make a persuasive case for such action where you are certain there is a closed market, when you have tried to negotiate, you have used multilateral instruments where possible, you have made a good-faith bilateral effort, and the other side has simply not cooperated. I think you then have to retaliate.

You must keep that very much in the picture as a possibility. You don't want to overuse it. You have to be careful and prudent where you use it. But I think you must do so in specific cases to deal with the problem you describe.

I think deadlines are very important. I met with the United States-Japan Business Council in Cleveland on Sunday, the first day of a meeting they are now having. I talked to many Japanese businessmen. What worried them most in this whole agreement is the deadlines. They were most critical of their own Government for accepting these 6-monthly reviews. They realized that keeps the pressure on, and the reviews will require some demonstration of forward movement or else difficulties will arise.

I think the administration was right to press for deadlines. Of the four principles that Ambassador Kantor mentioned this morning, I would put the greatest weight on that one—keeping the pressure on, having the heads of Government meet to review progress and requiring that the process lead to results. If there is no progress, you may have to retaliate.

Mr. MATSUI. Thank you.

Chairman GIBBONS. Mr. Hoagland.

Mr. HOAGLAND. Thank you, Mr. Chairman.

You were here, were you not, Mr. Bergsten, when I questioned Ambassador Kantor about the agriculture situation?

Mr. BERGSTEN. Yes.

Mr. HOAGLAND. These figures that I have here from the Nebraska Department of Economic Development I am sure are representative of our ability nationwide to export our agricultural products to Japan, and let me just repeat those because it has been an hour since I last had an opportunity to mention these figures.

In food and kindred products, Nebraska exported a total of $700 million, $440 million of which went to Japan, so that is quite respectable it seems to me. Yet, in crops, Nebraska's total exports were $65 million, and only $500,000 went to Japan.

I would be interested, first of all, if you have any observations that account for the difference between those two categories of agricultural goods; and then, second, what sort of things we need to do to break down barriers; and then, third, if you could describe for us, educate us as to exactly what the nature of the barriers is.

Mr. BERGSTEN. The nature of the barriers ranges across a wide spectrum. In some of the agricultural products Japan has traditional import quotas. The most famous case, of course, is rice with a zero quota.

I refer you to table 5.1 on page 184 in our book. The table is really stunning, and I would commend it to all the members of the committee for your future purposes.

This is, I think, the first ever analysis of the real effect of Japan's trade barriers sector by sector. We have a team of three Japanese economists, using Japanese data, working with us on another project. We put it into this book, constructing the tariff equivalent of Japan's nontariff protection across more than 100 sectors.

If you look at that table, the very top number, for rice, shows the famous 737 percent tariff equivalent. That is the measure of the real protection. Citrus fruits are over 600 percent, and oil seeds are over 600.

The nature of the barrier is different from product to product: in some cases it is a marketing board; in some cases it is a traditional quota. In some cases it is health and safety regulations that have the effect of reducing imports.

I stress that Japanese economists, using Japanese data, came up with these striking numbers. You are probably interested in wheat. The tariff equivalent is 477.8 percent. Soybeans is 423.6 percent. So if they convert their protection to tariffs as Ambassador Kantor wants them to do, at the levels suggested here they would still have a pretty protective regime that would require substantial negotiation to bring the numbers down. The numbers are very big. I think that explains in large part the discrepancy you see. The rice, wheat, soybeans, and even some of the processed products face tremendous tariff equivalents in Japan that, whatever the specific barrier, block out foreign products to an enormous degree.

Mr. HOAGLAND. These barriers are all there intentionally? They are an accident of institutional history in many respects, but, on the other hand, they are clearly removable by the Japanese if they wanted to do that.

Mr. BERGSTEN. Yes. In the case of agriculture, I think most of these are governmental restrictions, in some cases buttressed by agricultural cooperatives or the same kind of exclusionary private sector arrangements that we found in our more detailed analysis of protection in manufacturing. So there are some interactions between Government policy and the way the private agricultural sector operates. But I think most of these are susceptible to Government policy change or correction.

Mr. HOAGLAND. What do you suggest we do to bring these down?

Mr. BERGSTEN. I think Ambassador Kantor is right in focusing in the first instance on bringing these issues into the GATT through the Uruguay round.

The first step is to get this sector covered by the international rules. Address the tariff equivalents, of the type shown in this table, and start bringing them down. High and restrictive as these tariff equivalents are, they would be much more transparent and much easier to attack, if you were to convert the existing myriad hidden barriers to tariffs.

It is important to recognize that the GATT has been effective in getting Japan to reduce its agricultural import barriers in the past. You may remember that, in the late 1980s, the administration took 12 agricultural products to the GATT, arguing that Japan's restrictions violated its GATT obligations. On 10 of those 12 sectors, Japan accepted the GATT ruling that their procedures were illegal and they did liberalize them. Citrus and beef were handled bilaterally but under some of the same principles. In all of those cases, exports to Japan have expanded substantially.

We showed in our estimates that U.S. exports of both beef and citrus have more than doubled in the period since liberalization much more than was anticipated at the time.

My point is that, if you could bring the issues into the GATT, there is an overwhelming prospect that the GATT as a whole will rule against Japan's practices. If that happens, the record suggests that Japan has generally accepted the GATT ruling and liberalized its markets.

We obviously have to keep the bilateral pressure on throughout the process, but I think in the first instance, at least, the administration's strategy of bringing this whole agricultural sector into the GATT and converting the barriers into tariffs makes sense.

Mr. HOAGLAND. Let me ask you one last question. I wonder if you would describe for us the potential market for American agricultural products in Japan if these barriers are removed.

Mr. BERGSTEN. In the analysis we did in the book, which you referenced earlier, we did make some estimates of the potential increase of U.S. sales into the Japanese market, both in the aggregate and in terms of agriculture. You may be comforted to know that we believe that our agricultural estimates are the most solid in the book.

There had been some very detailed, extensive studies that we drew on that have estimated the impact of Japanese liberalization. If you will look at page 103 of the book, table 4.3 summarizes the results of two very elaborate studies that had been done of Japanese agricultural liberalization. These studies have been reviewed and are widely accepted around the world as valid. They come to a fairly wide range of estimates, and we adopted that range in our own work, but it does suggest with some precision and I think a lot of validity that there are large amounts of money involved, somewhere on the order of $2 to $6 billion.

Again, based on what I said before, most of the actual outcomes tend to exceed the estimates at the time, so these are probably conservative estimates. I wouldn't be surprised if the actual outcome, once those markets are liberalized, would be even bigger.

Mr. HOAGLAND. Well, the Japanese consumers are certainly paying an extraordinary premium, aren't they, for these sort of protectionist policies?

Mr. BERGSTEN. That table I referenced shows these enormous differences—sevenfold in the case of rice, threefold or fourfold in the case of soybeans or wheat.

There is another table on page 101, work done by the OECD, that shows the consumer subsidy equivalents, as the OECD calls them, across the board in agriculture. For Japan, the number is about 50 percent. It shows that for the entire agricultural sector, Japanese consumers are paying something like 50 percent more for their food than would be the case at market prices. And for some of the individual items such as rice, the number is much higher than that.

Mr. HOAGLAND. Well, let's hope that the new government shows more consumer sensitivity in response to these figures.

Mr. BERGSTEN. I have some optimism on that score from my own frequent visits to Japan and from talking to people there. We say in the book that the political revolution in Japan might actually lead to politicians there having to compete for votes on the basis of policies and improvements in the standard of living of the average Japanese person.

The leading Japanese business newspaper had a wonderful editorial a year or two ago headlined: "Rich Country, Poor People." Per capita income in Japan is now statistically 50 percent higher than ours at market exchange rates, but no analysis suggests that Japan's standard of living is anything like ours, in large part because of food prices.

So there is an enormous gap between the national wealth and the individual well-being, and once the politicians there start exploiting that, my guess is it could go very far very fast.

Mr. HOAGLAND. Well, let's hope they do it quickly for the sake of our agricultural exporters, among others.

Mr. BERGSTEN. Right.

Mr. HOAGLAND. Thank you.

Thank you, Mr. Chairman.

Chairman GIBBONS. All this leads me to ask you the question, in our negotiations with Japan, wouldn't we be better off if we negotiated with them not as United States versus Japan but as the rest of the world versus Japan?

I realize that such an approach might create a domestic political problem in the United States, but Japan has a pretty good record of responding to GATT decisions. Wouldn't the better place to deal with Japan be in the GATT rather than through bilaterals?

Mr. BERGSTEN. I think it is true that, wherever we can appeal to GATT rules and GATT procedures, we should do so. I mentioned the case in agriculture of a few years ago.

The problem is twofold. One is that many of the sectors where we need liberalization in Japan are simply not covered by the current GATT. The whole services component—financial services, the insurance markets, construction contracting—these industries are just not covered by the GATT in whole or in part. So you try to bring them under the GATT as, in fact, is being done in the Uruguay round. But you can't simultaneously just sit still and do nothing on the specific problems while you wait for the round to be concluded.

You will recall, more than most, that the Uruguay round was intended for completion 3 years ago. If this had been the case, many of these issues would have already been brought under the GATT umbrella, and we could be using it more now. That is the overwhelming reason for bringing the Uruguay round to a successful conclusion. We could then invoke it more often.

But right now a lot of the key areas are still outside its purview. The agricultural sector, as we know, has some coverage, but many parts of it are not covered, and that is, again, a major purpose of the Uruguay round. Even in some sectors where the GATT applies, such as subsidies and Government procurement, it does not do so adequately.

Over the longer term, I think we will be able to appeal to the GATT more in sectors such as supercomputers or construction contracting if we can expand the Government procurement code in a way that will be more effective, more comprehensive and cover more entities that will then be obligated to institute open bidding rules and the like. But, until you have negotiated such a code, you are pretty much forced to address these issues bilaterally.

The other big element of the GATT that has been a problem, of course, is its decisionmaking process. Its dispute settlement mechanism has been ineffective, it has been slow, and an individual country can veto the outcome and essentially keep itself from being declared guilty. We hope that will change with the Uruguay round package, and some of it has already begun to change, so I think 5 or 10 years from now we will be able to do much more of what you suggest, and I think it is highly desirable. Most of the world agrees with us that Japan must liberalize many of these markets much more extensively.

I think the administration has had another strong selling point in its current approach to Japan in that it has been seeking Japan's liberalization vis-a-vis all imports, not just toward U.S. products. The Bush administration made a big error, and really hurt the U.S. negotiating position around the world, when it made the auto and auto parts deal with Japan only for American autos and auto parts. That enabled the Japanese to go out and say to the rest of the world that the Americans are violating all of the multilateral principles. They are just trying to get their own products in. They will do it by shutting out your products. That was a big mistake.

The current administration has done it right. It is trying to open the Japanese market to all comers. Naturally, it pursues products where is thinks the United States has the competitive advantage and will do well, but the administration is trying to open these markets for all producers.

We studied the semiconductor agreement in our book. The semiconductor agreement opened Japanese markets and set market share targets for imports from all quarters, not just from the United States. Korean sales increased. European sales increased. Nobody could claim it was purely chauvinism on America's part.

Our study suggested that U.S. exports of semiconductors to Japan doubled, and the global sales to Japan of American semiconductor firms doubled. Those are two different things, of course, because the American semiconductor firms produce to a great extent in offshore locations, but the agreement liberalized for those products as well, so I think that was a model of how liberalization should be negotiated.

Alan Wolff is here. He is one of the architects of the semiconductor agreement. We strongly endorse the market-expanding part of the semiconductor agreement as a model for other sectors. We certainly suggest it had very positive results. But, again, it is crucial that it addressed imports from all quarters, not just from the United States and not even just for U.S. companies.

Chairman GIBBONS. Thank you very much. When I finish reading your book I will be happy to sit down and discuss it further.

Mr. BERGSTEN. I will be happy to have lunch and explain more of it anytime you want.

Chairman GIBBONS. Good.

Next we have a panel of American organizations: the American Electronics Association, Mr. Brenner; the Semiconductor Association, former Ambassador Alan Wolff; the American Insurance Association, Mr. Morein; and the Automotive Parts & Accessories Association, Mr. Kadrich.

Let's go first to the American Electronics Association.

STATEMENT OF ARNOLD BRENNER, CHAIRMAN, JAPAN ADVISORY COMMITTEE, AMERICAN ELECTRONICS ASSOCIATION; AND EXECUTIVE VICE PRESIDENT AND GENERAL MANAGER, JAPAN GROUP, MOTOROLA, INC.

Mr. BRENNER. Thank you, Mr. Chairman.

I am Arnold Brenner, executive vice president and general manager of the Japan Group at Motorola. On behalf of the American Electronics Association, I appreciate the opportunity to testify on the subject of United States-Japan trade and economic relations.

The American Electronics Association, AEA, represents over 3,000 companies in all segments of the electronics industry, including telecommunications, medical electronics, computers and peripherals, semiconductors and semiconductor manufacturing equipment, instruments, and software. Over 80 percent of AEA's membership is comprised of small entrepreneurial companies with fewer than 200 employees.

Electronics is the Nation's largest manufacturing sector, with approximately 2.3 million Americans employed directly in the industry. Worldwide sales of electronics firms now total over $400 billion per year. Moreover, as the tool builder for the rest of the economy, the U.S. electronics industry certainly would rank very high, if not number one, in strategic importance for the economic well-being of the United States.

One of the more important facts about our industry is that over 450 U.S. electronics firms have offices, people, and representation in Japan. This is an industry which has committed significant resources to compete for Japan's lucrative markets. These are not companies that can be criticized for inadequate efforts to sell in Japan.

Mr. Chairman, if the committee could come away from this hearing with just one message today, it should be this: A continuing electronics bilateral trade deficit with Japan represents a direct transfer of wealth, lost sales, and profits for U.S. companies and lost jobs for American workers. The Japanese must understand the importance our negotiators place on improvement in electronics trade.

Further, if we have learned anything from the past, it is that any trade negotiations must embody clear measures to indicate progress in our trade with Japan, and the United States must be willing to use, if necessary, our existing trade laws if the negotiations do not yield the expected results.

The overall bilateral trade deficit with Japan is concentrated in two sectors, autos and electronics, with electronics representing about 45 percent of the total deficit. This deficit in electronics has increased despite the devaluation of the dollar vis-a-vis the yen. It rose 12 percent in 1992, reaching $22.3 billion. Furthermore, the deficit continues to deteriorate, despite as many as 20 bilateral trade agreements focused in this sector.

What we seek are truly effective market access negotiations for electronics which reduce market barriers in Japan and provide a measurable, steady and substantial increase in American firms' sales and market share in Japan, commensurate with their global competitiveness.

Our relationship with Japan, both as a partner and a competitor, is critical to the future of this industry for two reasons. First, Japan is a significantly large market for electronics products. American companies today hold more than 50 percent of the world market, but our industry's sales in Japan are only about 19 percent of that market.

As an example, Motorola is generally regarded as being highly successful in Japan. However, if we in our company had the same share of market in Japan that we have in the rest of the world we

would do two and a half times the business there that we do today. Our market share in Japan defies our global leadership.

If the United States could increase their exports to Japan to eliminate only half of this gap, the effects would be enormous. U.S. firms' sales would increase by some $23 billion. This could generate some 200,000 to 500,000 new jobs, and the current $22 billion deficit in U.S. electronics trade with Japan would be significantly reduced.

Second, our industry is disadvantaged, trying to compete worldwide with a Japanese electronics industry that benefits from a largely sheltered home market. The economic effect of limitations on foreign access to the Japanese electronics market is to provide a significant profit haven in the form of an assured substantial home market, which enable the Japanese companies to become even stronger.

U.S. electronics companies confront a wide array of barriers to access the Japanese market. These practices, which we have detailed in written testimony, are interrelated and systemic. The barriers are concentrated in four general areas: Government procurement, exclusionary business practices, ineffective intellectual property protection, and market-limiting regulatory procedures often referred to as administrative guidance.

The AEA has provided the Government negotiators over 50 specific recent anecdotes demonstrating the obstacle course non-Japanese companies must run before they get to the marketplace. Just as an example, Mr. Chairman, here is a catalog book of Motorola's wireless telecommunications products which we can sell in the world and in the United States. Contrast that to our sales catalog book which we can sell in Japan. This is the example of market-limiting regulations.

U.S. Government efforts to deal with individual procedural barriers to electronics in Japan are less effective than treating them as a whole, comprehensive system. With its framework, the administration moves closer to this comprehensive approach. It recognizes the problem is not just macroeconomic. It is complex, and it is detailed—microeconomic.

We urge the administration and Congress to put a high priority on electronics because of the significant opportunities for export expansion, increase in productivity, and growth in high skill, high wage and high value-added jobs.

AEA is prepared to work with the Congress and the administration to achieve truly effective market access negotiations for electronics.

Thank you, Mr. Chairman. I will be happy to answer questions now or at the conclusion of our panel.

Chairman GIBBONS. Thank you, Mr. Brenner.

[The prepared statement follows:]

STATEMENT
BY ARNOLD BRENNER
EXECUTIVE VICE PRESIDENT AND GENERAL MANAGER, JAPAN GROUP
MOTOROLA, INC.

ON BEHALF OF
THE AMERICAN ELECTRONICS ASSOCIATION
BEFORE THE

Introduction

Mr. Chairman, Members of the Committee I am Arnold Brenner, Executive Vice President and General Manager, Japan Group at Motorola. On behalf of the American Electronics Association, I appreciate the opportunity to testify on the subject of U.S.-Japan trade and economic relations.

Motorola is the leading provider of wireless communications and electronic equipment, systems, components and services for worldwide markets. Our revenue in 1992 was $13.2 billion, with over 50% being derived from international sales.

The American Electronics Association ("AEA"), represents over 3,000 companies in all segments of the electronics industry, including telecommunications, medical electronics, computers and peripherals, semiconductors and semiconductor manufacturing equipment, instruments, and software. Over 80 percent of the membership is small, entrepreneurial companies with fewer than 200 employees.

Electronics is the nation's largest manufacturing sector with approximately 2.3 million American workers employed directly in the industry. Worldwide sales of electronics firms now total over $400 billion per year. Many of our firms derive fully half of their total revenues from export and overseas sales.

Key Points

- The bilateral trade deficit with Japan is concentrated in two sectors -- autos and electronics, with electronics representing about 45% of the deficit.

- This bilateral trade deficit in electronics remains, and, in fact, increased despite the devaluation of the dollar vis-a-vis the yen. It rose 12 percent in 1992 alone, reaching $22.3 billion, up from $8.9 billion in 1983.

- We believe it is also significant that our trade balance in electronics continues to deteriorate despite as many as 20 bilateral trade agreements in electronics. It is clear that without a comprehensive strategy for measuring results, monitoring and implementing increased market access, individual agreements will not produce appropriate results.

- For this reason, we commend the Administration's commitment to results-oriented negotiations with Japan and to establishing effective indicators to signal improvements or indicate problem areas for corrective action.

- Our market share in Japan defies our global leadership and competitiveness. The U.S. electronics industry has just over 50% of the global market share and yet in Japan we have a mere 18.8% (all segments of electronics including telecommunications, computers, software, medical equipments, semiconductors, instruments).

- As long as substantial and economically unjustifiable disparities exist between U.S. electronics firms' success in Japan and their much greater success in other markets, the U.S. electronics industry will consider negotiations unsuccessful.

- What we seek are truly effective market access negotiations for electronics which (1) reduce electronics market barriers in Japan and (2) provide measurable, steady and substantial increases in U.S. electronics firms' sales and market shares in Japan commensurate with their global competitiveness.

- U.S. electronics companies confront a wide array of barriers to access to the Japanese electronics market. These practices (detailed below) are interrelated, systemic and affect U.S. and other non-Japanese electronics companies in a wide range of products and sectors. The barriers are concentrated in four general areas: government procurement, exclusionary business practices, ineffective intellectual property protection, and market-limiting regulations. These barriers and practices -- and their economic consequences -- remain, despite devaluation of the dollar and numerous bilateral trade agreements over the last decade.

- Experience has shown that U.S. government efforts to deal with the trade barriers in electronics with Japan as separate, or separable, problems will be much less effective than treating them as a comprehensive system that has had the effect of locking many U.S. electronics firms and/or products out of Japan.

The Debate on Measuring Progress

AEA applauds the Administration's determination and focus on results and indicators to determine progress. It is eminently practical that our most important bilateral relationship is focused on quality and improvement. Both Japan and the United States should welcome a process where identifying barriers and implementing corrective action are seen as an opportunity for change and growth rather than disputes.

Japan is a country rich with experience in quality processes, where the focus is on meeting customer needs. Such a system traditionally has required the development by both industry and government of quantifiable measures to monitor and detect changes in performance, quality and demand. Yet, Japan has opposed the adoption of such measures for assessing the progress of trade agreements. This is difficult to understand, since the U.S. government has merely proposed a measurement concept that basically reinforces the Japanese quality process. With this frame of reference, establishing benchmarks simply provides an opportunity to determine improvements as well as identify in a timely manner where problems may be occurring, so corrective action can be taken.

Such benchmarks could include growth in market penetration, improvements in overall sales volume, and even procedural indicators that provide frequent portraits of the effects and extent of market access improvements.

Effect of Barriers to Access

U.S. and other non-Japanese companies face barriers in three principal contexts -- in their efforts to sell to governmental purchasers, to sell to Japan's commercial markets and to introduce and utilize technology in the Japanese market.

The companies that AEA represents are technological leaders in their fields, and are generally the market leaders in the U.S. and world markets other than Japan. These are not companies that can be criticized for inadequate efforts to sell in Japan. To the contrary,

they have been in Japan for extended periods of time, have substantial employment in Japan and have research and development, servicing, engineering and in many cases manufacturing facilities in Japan.

There is unambiguous evidence of the adverse effect of Japanese barriers to U.S. access to the Japanese electronics market:

- In 1990-1991, American companies held more than 50 percent of the world market for electronics products, but U.S. industry sales in Japan in the same period averaged only 18.8 percent of that market. The share of the Japanese electronics market represented by imports direct from the U.S. is even lower -- 6.8 percent in 1991.

- Japan imports a far lower percentage of its electronics consumption -- 12.5 percent -- than any other major industrialized country. Imports represent 35 percent of electronics consumption in the U.S. and 73 percent in Europe.

- In each of the key electronics sectors represented by AEA, there is strong statistical evidence of dramatic disparities in the market share of U.S. firms in Japan compared with their shares in other world markets. The same pattern is repeated if one looks at individual U.S. firms' shares of major segments of the Japanese electronics market.

- Japanese market access restrictions significantly contribute to the bilateral trade deficit with Japan in electronics. That deficit was $22 billion in 1992 and is expected to continue to grow. The Japanese Industry Development Association itself predicts that the United States' global electronics deficit with Japan will rise to $60 billion in the next 8 years, while Japan's global electronics surplus will exceed $100 billion. Along with automobiles, electronics trade is a principal contributor to the U.S.-Japan bilateral trade deficit.

IMPORTANCE OF THE ELECTRONICS INDUSTRY TO THE UNITED STATES

In discussing the industries issues, the economic importance to the United States of a competitive electronics industry should be understood by U.S. economic policymakers. The industry is a vital engine of jobs creation and economic growth for the entire U.S. economy, and the industry's technological leadership is critical to the competitiveness of the overall economy.

Even the most cursory examination of the statistics reveals the crucial importance of the electronics sector to the overall U.S. economy:

- Employment: Employment of 2.3 million, representing approximately 9 percent of the workforce.

- Output: An estimated $250 billion in production in 1992, representing approximately 15 percent of total U.S. manufacturing.

- Growth: In 1993, the five fastest growing manufacturing industries in the U.S., according to the Department of Commerce, will all be sectors of the electronics industry.

- Exports: Electronics exports of components and hardware were over 25 percent of output. In 1992, estimated total electronics exports were valued at over $50 billion, representing nearly 15 percent of total U.S. exports.

- Technology: In 1991, U.S. electronics companies spent more than 7 percent of sales on R&D. Few industries match this rate of investment in future technology.

Beyond these direct measures, the electronics industry's important role in the economy should be noted. In the modern information era, electronics form the backbone needed to increase productivity, innovation and growth throughout the economy. Electronics components, subsystems, and software are embedded in almost every product made by non-electronics industries today.

Banks, airlines and other service institutions cannot compete without modern, electronic computer and information systems, and many successful companies have devised their entire business strategies around innovative information processing. In manufacturing industries, electronics increasingly play a key role. New world-class factories use computers to link various production units and the rest of the company together, and electronic equipment is fundamental to all aspects of automation and quality control that are at the heart of increasing U.S. competitiveness in the manufacturing sector. Electronics technology is also critical to U.S. national security, both in terms of military sophistication and in terms of maintaining a technologically superior industrial base.

Finally, it is important to emphasize that electronics, as a high-technology manufacturing sector, generate the kinds of jobs that are critical to raising the standard of living in this nation. These are high-wage, high-skill jobs, with prospects for increasing levels of wages as markets for the products grow in the U.S. and around the world. Thus, a denial of access to the U.S. electronics industry to the world's second largest market has serious consequences to the overall economy.

IMPORTANCE OF THE IMPROVED MARKET ACCESS IN JAPAN FOR THE U.S. ELECTRONICS INDUSTRY

The U.S. electronics industry is the preeminent global force in electronics. The U.S. continues to be a highly competitive location for electronics production. Despite these undisputed facts, the U.S. electronics industry's competitive position was eroded in the 1980s in large part due to lack of effective access to the Japanese market.

In evaluating the importance of access to Japan's market to the U.S. electronics industry, two central facts must be kept in mind:

- The U.S. industry's share of world electronics production in 1985 was 64.5 percent. By 1991, it had fallen to 50.5 percent (or by 14 percentage points), while Japan's share rose by 7 percentage points.

- The United States' electronics trade deficit with Japan was only $3 billion in 1979. By 1992, it had risen to $22 billion. The deficit rose 12 percent in 1992 alone, even though the value of the dollar fell substantially against the yen.

While the U.S. industry has made great strides in reversing the trend in the loss of its global market position, the lack of effective access to Japan seriously impedes that effort. There are two principal reasons why Japan market access is so critical to the industry's competitive position:

First, Japan is an immense and rapidly growing market for electronics products. With consumption estimated by the Electronics Industry Association of Japan at $122.4 billion in 1991, it trails only the United States as the world's second largest market. As such, it is a market in which the U.S. electronics industry cannot accept relegation to an artificially small level of sales, especially given the degree of openness of the U.S. market for Japanese products. American companies today hold more than 50 percent of the world market for electronics products, yet our industry's sales in Japan represent only 18.8 percent of that market -- slightly more than one-third our global market share and less than one-third our share of markets outside Japan.

Second, our industry cannot long continue to compete worldwide with a Japanese electronics industry that benefits from a largely sheltered home market. The economic effect of limitations on foreign access to the Japanese electronics market is to provide a significant subsidy -- in the form of an assured substantial volume of home market sales, often at artificially high prices -- to finance Japanese companies' development of technology, their worldwide marketing and their export pricing.

To illustrate the impact of greater market access, if U.S. companies could increase their exports to Japan sufficiently to eliminate only half of the gap between our Japan and non-Japan market success, the effects would be enormous:

- U.S. firms' sales would increase by some $23 billion;
- This would generate some 200,000 to 500,000 new U.S. jobs;
- The current $22 billion deficit in U.S. electronics trade with Japan would be eliminated; and
- The 1992 U.S. merchandise trade deficit of $102 billion would be reduced by over 20 percent.

JAPAN'S SYSTEMATIC BARRIERS TO MARKET ACCESS

The single most important element to understand about the barriers to U.S. firms' access to Japan's electronics market is that the barriers are embodied in a system of access-denying practices. A negotiating initiative that deals separately with one or more individual practices cannot be effective, because elimination of one barrier practice will leave in place other practices having similar access-denying effects.

Because of the systematic nature of Japan's electronics market access barriers, it is important to analyze the various practices together, not separately, in each context in which U.S. firms encounter them in the Japanese market. Such a systematic analysis is set forth below for each of the four contexts in which U.S. electronics firms have access problems in Japan:

- Government Procurement
- Exclusionary Business Practices
- Effective Intellectual Property Protection,
- Market-Restricting Regulations

Barriers to U.S. Electronics Firms' Access to Japan's Government Markets

U.S. companies in the electronics sector regularly find that their success in selling to governmental purchasers in Japan falls far short of their success in Japanese commercial/industrial markets (even though those markets are also characterized by substantial market access barriers).

The phenomenon of denial of access to Japan's government procurement markets is familiar to U.S. Government officials from its from their recent negotiation with Japan on procurement of computers. The other segments of the electronics industry encounter discriminatory and preclusive procurement practices quite similar to those experienced by U.S. computer manufacturers, with similar access-denying effects

While Japan is a signatory to the GATT Government Procurement Code, it has not met the spirit of openness of that code. Its failure to do so has led to repeated demands for additional commitments by the Japanese Government to change certain procedures in the procurement process. The NT/T Agreement and the July 1985 "Action Plan," for example, were designed to facilitate market entry by foreign suppliers through the elimination of specific barriers identified in those sub-sectors. These additional commitments have been of little greater value than the GATT Code itself, however, and there has not been any system-wide opening of the procurement market for two principal reasons.

First, the predicted benefits of each agreement, to the extent they are realized, are limited to a single sub-sector. The most notable example is the January 1992 "Measures Related to Japanese Public Sector Procurement of Computer Products and Services." The Government of Japan's recent commitments to open public sector procurement of computers may increase U.S. access to the Japanese government computer market. However, the same barriers exist for other sectors of the electronics industry, and the commitments in this agreement and other new provisions that are not addressed in the agreement should be extended to cover all electronics industry products. The November 1991 "Understanding on Government Procurement," although an acknowledgement that barriers exist throughout the procurement procedures and decision-making of the Government of Japan, was independently and voluntarily produced,

unenforceable and falls far short of meeting the objectives U.S. industry had formally identified to Japan.

Second, while improvements have occurred in the form of temporary, limited access to specific sectors after heavy foreign pressure has been applied, any permanent gains in access have not been commensurate with the international competitiveness of the U.S. companies involved. New restrictive practices and old relationships among suppliers and procuring agencies continue to preclude real gains in sales and market share.

As the Executive Branch knows from these access negotiations in the computer context, the nature of Japan's electronic-sector government procurement access barriers runs from denial of the right to bid to a wide variety of discriminatory standards and procedures. In addition, U.S. firms encounter anticompetitive practices by their Japanese rivals in the procurement context. Set forth below is a representative sampling of access-denying practices reported to AEA by companies recently surveyed.

- Fragmented and disparate qualifying processes;
- Irregular and discriminatory planning procedures;
- Selectively disclosed and biased design processes for specific projects;
- Excessive sole sourcing;
- Arbitrary allocation of contracts between Japanese and foreign suppliers;
- Bid evaluation by price alone, which encourages "buy-ins;"
- Ineffective bid protest procedures;
- Inadequate and unenforceable coverage under the GATT Government Procurement Code;
- Limited reporting of statistics;
- Post-award project scaledowns; and
- A general "Buy Japan" bias that runs deep in the government bureaucracy.

In addition to the foregoing, U.S. electronics companies are adversely affected in the government procurement markets, as well as in Japan's private sector, by the subsidization of certain of their Japanese competitors, by collusive practices by their Japanese competitors, and by the effects of Japan's intellectual property practices.

Barriers to U.S. Participation in Japan's Commercial and Industrial Electronics Markets

The most fundamental barriers to access to the Japanese commercial market are the various manifestations of Japanese consumers' refusals to deal with, or their arbitrary allocation of a very limited share of the market to, foreign suppliers, despite

foreign suppliers' ability to supply a competitive product in terms of price and technology. Such practices are even applied to foreign suppliers that offer more advanced products than are being produced by Japanese competitors. These refusals to deal and arbitrary allocations are often manifest in purchaser specifications, which depart from international norms and are skewed toward Japanese competitors. Another pervasive barrier is refusal to permit foreign firms to participate in the "design-in" process, by which a Japanese industrial customer will work with one or more Japanese supplier to design product specifications.

These practices of Japanese industrial consumers exist in industry segments where keiretsus are dominant as well as areas where such keiretsus are not an important factor. Japan's keiretsus, or industrial groups, consist of either conglomerates or vertical grouping of companies that are characterized by long-term association, cross-holdings of stock and extensive business dealings. With vertical keiretsus, the companies hold each other's shares, exchange information and cooperate in new ventures. Since the relationship is vertical, the closest ties are between buyers and suppliers or between maker and distributor in the group.

These restrictive practices are, on their face, inconsistent with Japan's antitrust and fair competition laws. Thus, important AEA goals are to end Japanese government tolerance of such anticompetitive activities, obtain Japanese government commitments to take aggressive action against such unfair practices, and adopt measures to correct the exclusionary effects of those practices. Most important, however, is for the Government of Japan to make it clear to industrial purchasers of electronic products that they must end their discriminatory purchasing policies.

Foreign firms also encounter governmental barriers in their efforts to sell in Japanese commercial and industrial electronics markets, including:

- Governmental regulatory policies that discriminate against foreign sellers and that are often designed to prevent or limit sales of new or more advanced products by foreign companies until Japanese firms can achieve technological and/or cost competitiveness (see further discussion below),

- Discriminatory standards established by the government or by Japanese company groups, and

- Subsidies to U.S. firms' Japanese competitors

Barriers to U.S. Electronics Firms' Introduction and Utilization of Technology in the Japanese Market

The Japanese intellectual property system effectively deprives a substantial number of U.S. electronics firms of a critical competitive advantage they would otherwise have in their efforts to sell to Japanese industrial customers -- an exclusive and enforceable right to their own innovative products. The lack of effective patent protection stems from both the delay in the issuance of patents (especially broad patents which Americans are prone to file) and the failure to provide effective and timely enforcement for the rare patent which issues in time to be a factor in the Japanese marketplace.

The Japanese intellectual property system, though it borrowed many of the basic procedures found in European patent systems, over the years developed a substantially different orientation from that found in the patent systems of other developed nations. Unlike patent regimes in Europe and the United States, the Japanese intellectual property system is oriented toward fostering early disclosure and sharing of innovative technology among competitors, rather than rewarding inventors with exclusive rights to the fruits of their labors for a period of time.

Thus, there has been little emphasis within the Japanese system on prompt processing and issuance of patents which might form the basis for a time-limited marketplace monopoly in promising technologies. Instead, the local tradition has been to countenance a large number of narrow patent applications, but which nonetheless increase the ability of Japanese businesses to negotiate cross-licenses and provide a shield against owners of patents seeking to enforce their rights.

While large U.S. companies are able to participate to some degree in the beneficial aspects of this system, they are significantly hampered in licensing and otherwise exploiting their technologies by virtue of the lengthy delay in patent issuance and uncertain enforcement prospects. However, the system poses an insuperable obstacle to smaller companies whose market prospects rely on a narrow but highly innovative product line -- especially in the electronics market where product cycles are short and delay in effective market penetration dooms a product to failure. Small companies tend to lack the financial resources and staying power to overcome the burdens posed by the patent system in Japan.

The specific aspects of the Japanese patent system which combine to present this burden include:

- Unreasonable delay in examining patent applications, which can be attributed to the following conditions:
    - the system is clogged by many narrow applications,
    - too few patent examiners are available in view of the volume of patents to be examined, and
    - the examiners have little time and expertise to examine applications which contain broad claims that require assessment against large volumes of prior art.
- Unreasonable delay in issuing examined patents because of a system of pre-grant oppositions:
    - oppositions frequently are protracted and repetitive, as Japanese competitors frequently oppose, one after the other, using the same or similar arguments, and
    - decision is slow to be rendered, particularly if it would be adverse to local opposers.
- Enforcement mechanisms are inadequate:
    - the judiciary does not sit frequently enough to dispose of suits in a reasonable period,

- the judiciary is not adequately trained to handle patent adjudications, and

- the judiciary lacks jurisdiction to determine patent validity issues which arise during infringement suits; delay occurs when this issue is referred to the JPO.

Market-Restricting Regulations

Many of the regulations adopted by the Government of Japan appear designed principally to provide the environment necessary to enable indigenous manufacturers to close the technology gap with foreign competitors and achieve an unfair competitive advantage for their products at home and abroad. In AEA, member companies' experience, simply tinkering at the margins of these regulations neither removes their inherent discriminatory intent nor addresses the problems of market access and product profitability.

One case in point is Japan's current prohibition on customer owned and maintained (COAM) cellular subscriber equipment and the related exorbitant fees for leasing and service. Unlike all other major countries in the world, all of the subscriber terminals in Japan are leased from the carrier, and the lease rate is combined with the monthly service charge into a rate that is typically three time that of the U.S. Japan's Ministry of Posts and Telecommunications (MPT) strictly regulates this rate, which is generally independent of the manufacturer's product.

Although MPT has announced that they are ready to open the cellular subscriber equipment market to COAM in April 1994, the previous delay in market liberalization has enabled Japanese companies to close the technology gap with Motorola. When first introduced in Japan, Motorola's Microtac cellular phone was light-years ahead of its competitors. Now, there are six major Japanese vendors, and more coming with personal size cellular phones -- an opportune time for MPT to open the internal market to competition, now that there are indigenous manufacturers.

Moreover, MPT has not agreed to reduce service charges for cellular subscriber equipment. Maintaining inordinately high usage fees will severely limit consumer demand, reduce the incentive for manufacturers to introduce further technologically advanced products and circumscribe an already-limited market. By contrast, allowing market forces to set service rates would expend the pie for everyone, Japanese and non-Japanese manufacturers and providers alike.

CONCLUSION

Experience has shown that U.S. government efforts to deal with individual procedural barriers to electronics in Japan have not been effective in dealing with the comprehensive system of barriers which has, in effect, locked many U.S. electronics firms and/or products out of Japan.

With its "Framework", the Administration moves closer to this comprehensive approach -- it recognizes the problem is not just macroeconomic, it's also microeconomic. We urge the Administration and Congress to put a high priority on electronics, which offers significant opportunities for export expansion, increase in productivity, and growth in high-skill, high-wage and high-value-added jobs. AEA is prepared to work with Congress and the Administration to achieve truly effective market access negotiations for electronics.

Thank you, Mr. Chairman. I'll be glad to answer questions.

Chairman GIBBONS. That is startling visual evidence that you have there. Your catalogs, I mean.

Mr. BRENNER. Yes.

Chairman GIBBONS. Is that Japanese catalog printed in English or Japanese?

Mr. BRENNER. No, it is printed in Japanese as a matter of fact. You can sort of see it from across the table. Our product names are generally in English, but it is printed in Japanese.

Chairman GIBBONS. All right.

Mr. Wolff.

STATEMENT OF ALAN WM. WOLFF, COUNSEL, SEMICONDUCTOR INDUSTRY ASSOCIATION

Mr. WOLFF. Thank you, Mr. Chairman.

I would like to join in congratulations that Fred Bergsten offered to the administration on the achievement at the Tokyo summit, and I do recall that Bonn summit in 1978 in which the Tokyo round negotiations were given a boost.

I would also like to congratulate the committee on holding this hearing on the important subject of access to the Japanese market. It has been a very troubling one.

Today I am here on behalf of the Semiconductor Industry Association. I have been counsel to SIA since 1980.

This committee first heard about the semiconductor problem in about 1970 when the U.S. administration at the time, the U.S. Trade Representative, Bill Everly, engaged in negotiations to open the Japanese market. There were a series of negotiations over the years, constantly promising to gain access to the Japanese market and removing the formal trade barriers, but the market access that was promised did not materialize.

SIA had what we call the worm chart which demonstrated our lack of progress. We were always at 10 percent, year in and year out. Fred Bergsten to the contrary, exchange rates didn't change that line one iota. We simply were not welcome in the Japanese market. We were residual suppliers.

In 1986, finally, after three prior agreements had been negotiated on market access, the administration negotiated a results-oriented agreement. We had a target in it, and it worked. It has actually borne fruit.

The reasons were, number one, the U.S. industry is competitive. In every market outside of Japan we outperform the Japanese by a 2-to-1 ratio, yet we had very little access in Japan. Motorola, Mr. Brenner's company, Intel, and Texas Instruments, for example, are able to supply chips to the automotive market. Everywhere in the world U.S. producers had a dominant share of the automotive market: 70 percent in the United States, 60 percent in Europe, and historically only 1 percent in Japan. We are now up to about 8 percent in Japan. We are moving in the right direction.

So, number one, we are highly competitive.

Number two, the U.S. industry devoted the necessary resources to selling in the Japanese market. We have an office there for the association. We have opened a design center or other facility in Japan every month since the agreement went into effect in 1986. We have engaged in an enormous amount of process, but that proc-

ess wouldn't have amounted to much of anything, and the process wouldn't even be taking place without a quantitative target.

Number three, seriousness of purpose. The U.S. Government demonstrated that it stood behind gaining access to the Japanese market. President Reagan imposed sanctions in 1987. The Japanese industry and the Japanese Government knew that we would not abandon our attempts to gain access in Japan.

The degree of congressional interest has been unprecedented for a high technology product, and that has paid off. The administration gave us a high priority because the Congress gave us a high priority.

Fourth, we faced a market that wasn't operating. We needed some sort of quantitative target to serve as a goal to the companies that simply refused to even allow our salesmen to call on them.

This is not a consumer item. It is not something like beef or citrus where if you can get it to a market at a reasonable price, it will be picked up by consumers.

These sales are to industrial users. They are our competitors. They have a division that produces semiconductors. They have a division that consumes semiconductors. And they would really rather not buy foreign. Well, we had to change that.

Fifth, the use of benchmarks. We don't want the 20-percent benchmark to be a ceiling. We don't want it to be a quota. What the benchmark has been is a very useful objective to motivate everyone in Japan and here to make the additional efforts that were needed, and we got the cooperation of the Japanese Government and industry.

Ambassador Kantor has said he wants to see a minimum, an average of 20 percent at each of the four quarters of this year. This is still a matter of concern. We have slipped from the 20.2 percent we had in the last quarter of the last year to 19.6 percent this year in the first quarter. We need this committee and the Congress to demonstrate continued strong interest.

I think we need a tough minded pragmatic approach. I believe we are getting that from Ambassador Kantor. The U.S. Government is headed in the right direction with the framework agreement which includes enforcement, as Ambassador Kantor said this morning, an existing agreements.

Japan is the most important foreign market to U.S. semiconductor producers. We cannot be competitive without access to Japan. Every percentage point of the Japanese market is currently worth in excess of $200 million. SIA favors open trade.

We are making progress. We are gaining in market share. We are gaining in long-term relationships. We are gaining in the design-in of our products into the heart of Japanese consumer products and computers.

For example, in the camcorders that the Japanese produce so well, the chip in it—the integrated circuit that takes out the shaking of someone's hand from the picture—is an American product. In fax modems, the transmission from a fax machine, the chips are basically American.

I hope that the U.S. Government will dedicate the amount of resources that are necessary for followup. The U.S. Government has made this commitment in the case of semiconductors, and if they

do it in the case of, more broadly, electronics and other areas, we will make some real progress with Japan.

Thank you, Mr. Chairman.

[The prepared statement and attachments follow:]

STATEMENT OF

THE SEMICONDUCTOR INDUSTRY ASSOCIATION (SIA)

INTRODUCTION

The Semiconductor Industry Association (SIA) is pleased to have the opportunity to testify before this Committee about an issue which is SIA's top public policy priority -- access to the Japanese semiconductor market and the U.S.-Japan Semiconductor Agreement. My name is Alan Wolff. I have been counsel to SIA since 1980, and I am representing SIA today.

The SIA is comprised of U.S.-based semiconductor manufacturers. Its member companies account for 85 percent of U.S. semiconductor production and employ over 240,000 Americans. A list of member companies is attached. The SIA was created in 1977 to address the public policy issues confronting the industry. SIA concentrates its energies on those issues which affect the ability of the industry to remain internationally competitive.

Members of the SIA have been actively involved in gaining access to the Japanese semiconductor market since the association's founding. The Japanese government and industry actively pursued policies which restricted access to Japan's market and promoted the development of Japan's domestic semiconductor industry. These actions, combined with Japanese dumping of semiconductors in the U.S. market in the 1980s, resulted in the near destruction of the U.S. memory chip industry. The U.S. industry and government, after years of negotiations with the Japanese on semiconductor trade (see chart 1), sought to address the access problem in Japan in a way more likely to lead to actual results.

The 1986 U.S.-Japan Semiconductor Agreement included a side-letter in which the Japanese committed to provide market access and a 20 percent foreign share benchmark to be achieved by July, 1991. The 20 percent benchmark was chosen because its achievement was a clear indication that access to the Japanese market was no longer restricted. Had the market been open, foreign share would have been in excess of one-third. It became obvious in 1990 that this goal would not be reached so the U.S. and Japan concluded a second Semiconductor Agreement in 1991. The Agreement extends the original commitment of 20 percent to the end of 1992, with gradual and steady progress in market share continuing thereafter. A historical view of the facts highlights why the use of quantitative indicators of progress along with other factors have been essential to encouraging market forces in Japan's semiconductor market.

BACKGROUND

The 1986 and 1991 Semiconductor Agreements were a response to Japanese targeting of the semiconductor industry, barriers to the Japanese market, dumping in the U.S. and third-country markets, and the failure of previous attempts to produce concrete results.

Formal Protection of the Japanese Market:

Before the 1970s, the Japanese semiconductor market was protected by a wide range of formal and informal barriers. Imports were restricted by licensing requirements and quotas. Japan precluded foreign investment by placing semiconductors on the "negative list" -- foreign majority ownership in such industries was not permitted without prior government approval, which was almost never granted. The Japanese Ministry of International Trade and Industry (MITI) required the Japan Electronic Computer Company, a government-subsidized computer leasing company that served as a leading source of Japanese computer demand, to accept only computers that satisfied a local content requirement, which was progressively tightened from 80 to 95 percent. MITI also informally pressured semiconductor users to use Japanese-made devices. During this period, with extensive government support, Japanese semiconductor producers became internationally competitive and began challenging the U.S. industry in world markets.

Japan's Liberalization Countermeasures:

In 1971, the Nixon Administration mounted a major effort to persuade Japan to liberalize imports of computers and computer parts. Japan initially resisted U.S. pressure, but eventually agreed to liberalization after the U.S. threatened to lodge a complaint under the General Agreement on Tariffs and Trade (GATT). Japan pledged to liberalize semiconductor imports and foreign investment in a series of negotiations between 1971 and 1975.

At the same time that Japan agreed to eliminate its formal restrictions, however, the Japanese government also developed a series of "liberalization countermeasures" to offset the effects of liberalization. These countermeasures included MITI subsidies to encourage product specialization among the producers, government sponsorship of joint R&D projects, continued administrative guidance to buy Japanese, the creation of horizontal links between Japanese producers, and encouragement of tight relationships between Japanese producers and consumers of semiconductors.

As a result of these steps, the U.S. share of the Japanese market in the post-liberalization period remained virtually the same as the U.S. share during the period of formal protection, generally around 10 percent. In specific product areas, U.S. companies encountered a recurring phenomenon: U.S. firms could achieve sales in Japan with a given device as long as sufficient quantities of a competing Japanese product were not available. As soon as Japanese firms could supply the product, U.S. firms' sales fell dramatically, sometimes to zero. Given the buy-Japan policies and the increasing ability of Japanese companies to replicate foreign chips, the U.S. share began declining in 1980 and, in 1982, was lower than the U.S. share in 1974, the last year the market was protected by quotas.

High Technology Working Group:

By the beginning of the 1980s, the market access problems U.S. semiconductor firms encountered in Japan and the alleged dumping of Japanese devices made semiconductors a subject of significant bilateral trade friction. In 1982, the U.S. and Japanese governments established an informal working group to address conflicts in high technology products called the "U.S. - Japan Work Group on High Technology Industries." In a set of recommendations approved by the cabinets of both governments, Japan agreed to eliminate barriers to market access in high technology products and, in 1983, MITI said that it would encourage Japanese companies to increase their purchases of U.S. semiconductors.

In retrospect, this agreement served little purpose other than to dissipate U.S. pressure on Japan to open its semiconductor market. Increased U.S. penetration of the Japanese market lasted only as long as the world-wide boom in demand for semiconductors. In late 1984, as semiconductor demand started to decline, U.S. companies immediately saw orders cut back and a loss in market share. U.S. companies reported that Japanese firms showed little or no interest in forming long-term relationships and foreign sales were not increasing. By mid-1985, the U.S. share of the Japanese semiconductor market was actually lower than it had been when the recommendations were adopted at the end of 1983.

The 1986 and 1991 U.S.-Japan Semiconductor Agreements:

In 1985, in reaction to Japan's violation of its 1983 commitments, SIA filed a petition against Japanese semiconductor producers pursuant to section 301 of the Trade Act of 1974.1/ At about the same time, Micron Technology filed an antidumping case in reaction to dumped Japanese 64K DRAMs, Advanced Micro Devices, Intel, and National semiconductor filed an antidumping case in reaction to dumped Japanese EPROMs, and the Department of Commerce self-initiated an antidumping case in reaction to dumped 256K

1/Petition of the Semiconductor Industry Association, Investigation of Semiconductors under Section 301 of the Trade Act of 1974 before the Section 301 Committee of the Office of the U.S. Trade Representative (filed June 14, 1985).

and above DRAMs. The massive dumping that occurred in 1985 and 1986 was substantially attributable to Japanese government targeting and the closed Japanese market. Japan's closed market gave its firms a sanctuary and reduced the uncertainty associated with investing in new manufacturing capacity.

At the same time that these cases were pending, the United States and Japan entered into long and arduous negotiations designed to reach an overall agreement on semiconductors. The U.S. government was proceeding toward a section 301 determination against the Japanese government, but suspended the proceeding when the 1986 U.S. - Japan Semiconductor Agreement was signed. Under the 1986 Agreement, Japanese semiconductor producers agreed not to dump in any world market. The Japanese producers entered into antidumping suspension agreements with the United States government for DRAMs and EPROMs and established a fair market value (FMV) system to ensure that Japanese exports were above costs. Because of U.S. frustration over the failure of prior agreements to produce market opening results, U.S. negotiators pressed for a more explicit market access commitment, which led to a side letter exchanged concurrently with the text of the main Agreement. In the letter, Japan committed itself to providing market access and agreed to a measure by which to judge progress:

> The Government of Japan recognizes the U.S. semiconductor industry's expectation that semiconductor sales in Japan of foreign capital-affiliated companies will grow to at least slightly above 20 percent of the Japanese market in five years. The Government of Japan considers that this can be realized and welcomes its realization.

Despite the commitment, foreign market share in Japan remained stagnant in the months after conclusion of the 1986 Agreement. Although Japanese firms solicited more information from U.S. firms about their products, there was little evidence of Japanese interest in new supply relationships. Coupled with clear evidence of Japanese noncompliance with the antidumping provisions of the 1986 Agreement, the failure of the market access accords provided the basis for the formal imposition of sanctions by the U.S. government against Japanese electronics products for breaches of the 1986 Agreement. On April 17, 1987, President Ronald Reagan announced the sanctions.2/

U.S. retaliatory action, along with the prospect that Japan might be designated as a "priority" country pursuant to the Super 301 provisions of the Omnibus Trade and Competitiveness Act of 1988, appeared to bring about a major change in attitude within Japan. The U.S. share of the Japanese semiconductor market rose from 8.6 percent during the first quarter of 1987 to 12.2 percent during the first quarter of 1990.

By 1990, however, it was evident that the target foreign market share of 20 percent would not be reached by the time the 1986 Agreement expired on July 31, 1991. Foreign market share was only 13.0 percent by the first quarter of 1990, and the growth in U.S. market share was leveling off (see chart 2). Nevertheless, the 1986 Agreement had led to increased foreign market share and greater efforts by the Japanese to increase foreign sales and the design-in of foreign products. Consequently, SIA preferred the negotiation of a new agreement that would build on the existing momentum toward a more open Japanese market to the alternative of new sanctions. Accordingly, SIA and the Computer Systems Policy Project (CSPP)3/ jointly proposed that the President negotiate a new semiconductor agreement maintaining the emphasis on market access for U.S.

2/Presidential Determination Under Section 301 of the Trade Act of 1974, 52 Fed. Reg. 13,419 (Apr. 22, 1987).

3/The CSPP, an affiliation of the chief executive officers of 12 U.S. computer companies, is designed to develop and advocate industry positions on trade and technology policy issues. CSPP's members are the CEOs of Apple, AT&T, Compaq, Control Data, Cray Research, Data General, Digital, Hewlett-Packard, IBM, Sun Microsystems, Tandem, and Unisys.

semiconductors. The United States and Japan reached a new accord in which the government of Japan reaffirmed, this time publicly, in the body of the Agreement, its recognition of the expectation that foreign market share in Japan should reach at least 20 percent by the end of 1992. While the 1991 Agreement extended the market access provisions of the 1986 Agreement for five years, it set a 17 month period for reaching or exceeding the 20 percent objective, with steady progress to follow. While the Agreement's duration is five years, both governments will review and jointly decide after three years whether to terminate the Agreement before July 31, 1996.

Following early indications that the Japanese would not reach the 20 percent benchmark at the end of 1992, Congressional and Administration attention focused on the issue of compliance. Foreign share of the Japanese semiconductor market then reached 20.2 percent in the fourth quarter of 1992. The interim goal of the Agreement was therefore achieved.

However, foreign market share dropped in the first quarter of 1993 to 19.6 percent and early data indicates a further slip in market share during the second quarter of 1993. Nevertheless, the achievement of the interim goal demonstrates that foreign suppliers can supply the Japanese semiconductor market. Extraordinary efforts by both Japanese buyers and U.S. sellers have proved that with mutual efforts, and with intensive participation by governments to foster this process, success is possible. Foreign share of Japan's market can not only achieve a 20 percent benchmark level, but can continue to grow.

FURTHER PROGRESS IS NECESSARY

The question now is how further progress can be made. The 1991 Agreement specifies that there should be a "gradual and steady" increase in the foreign share of the Japanese semiconductor market beyond 20 percent -- until the Agreement expires on July 31, 1996. In effect, the 20 percent target in the Agreement is a milestone toward the ultimate objective of a larger share in Japan based on the competitive merits of foreign products. In part because the U.S. share of all semiconductor markets in which the U.S. and Japan compete, outside of the Japanese market, is nearly twice the share of Japanese producers -- 53.5 percent U.S. to 24.5 percent Japanese -- the 20 percent benchmark contained in the Agreement is rightly viewed as a reasonable threshold for obtaining full access to the Japanese market (see chart 3).

On March 19, 1993, Ambassador Michael Kantor stated that "gradual and steady growth means <u>at least</u> . . . an average of 20 percent foreign market share penetration of the semiconductor market in Japan over the next four quarters." Given that the average foreign share during 1992 was only 16.7 percent, the U.S. Government must make the Agreement a top priority of U.S. trade policy in order to ensure that the average foreign share during 1993 is at least 20 percent on average, and that foreign access continues to grow.

A gradual and steady increase in foreign market share beyond 20 percent will not occur without substantial additional purchasing efforts by Japanese consumers. Although the increased market share in Japan in 1992 is a significant accomplishment, this does not imply satisfaction that full access to the Japanese market has been achieved. It has not. Despite the progress made to date, a substantial gap remains. Semiconductor producers have a higher market share outside of Japan than they have in Japan for each and every type of semiconductor product. The "gap analysis" presented in the attached chart (see chart 4) demonstrates that further progress in obtaining greater market access in Japan is possible to a small degree for some products and to a very large degree for most others. The gap analysis is presented not as a political statement or as an indictment of Japan, but as an indicator that progress toward greater market access can be made across a broad spectrum of products. Foreign producers can and should satisfy more of Japan's semiconductor demand.

To make further progress in increasing foreign market share, foreign products must be accepted to a greater degree in Japan. Foreign semiconductors must be designed into the heart of Japanese electronic systems in more cases. Such "big ticket" design wins lead to interdependence of suppliers and customers. Mutual dependence is the natural result of an open international trading system and it is the necessary goal of an open international trade policy.

As continued progress in market access is achieved, the two industries have been moving from confrontation to cooperation. The two industries can increasingly engage in joint efforts to work together on activities that result in creating new applications for semiconductors and new markets so that both industries will benefit simultaneously. Cooperation on environmental issues would also be beneficial.

Semiconductors have been a bellwether in U.S.-Japan relations. Further success in this sector would indicate that broader success is possible in the world's most important -- and troubled -- trading relationship.

WHY THE SEMICONDUCTOR AGREEMENT WORKS

The 20 percent market share benchmark in 1992 was achieved for a number of reasons. U.S. government support for the Agreements, U.S. semiconductor industry efforts to increase their competitiveness, and the industry's continued investment to serving the Japanese market were all critical elements for achieving the 20 percent figure.

First, strong U.S. government support for the Agreement and a willingness to take action have been indispensable. One example is the trade sanctions imposed by the Reagan Administration in 1987 because little progress was being made in opening Japan's market. Once sanctions were imposed, Japan realized that the U.S. government was committed to seeing the accord enforced. As a consequence, efforts by chip users in Japan increased significantly. Congressional interest has also been vital. In April 1992, the Senate Finance Committee requested that the Bush Administration review Japan's compliance with the 1991 Agreement. In August 1992, after a two-month U.S. interagency review, the U.S. government concluded that "since the Agreement came into effect in August 1991, efforts by the Japanese government and Japanese industry to improve market access for foreign semiconductor suppliers have not, to date, resulted in sufficient progress."4/ Shortly thereafter, by the fourth quarter of 1992, foreign semiconductor sales to Japan increased significantly.

Second, the U.S. semiconductor industry took vigorous and effective steps to boost its own competitiveness in Japan and elsewhere. U.S. firms improved quality and service, and undertook initiatives to boost the performance of microelectronics educational programs in American universities through the Semiconductor Research Corporation (SRC). The U.S. industry also continues to provide $100 million annually to the SEMATECH R&D government-industry consortium in order to improve the competitive position of American semiconductor manufacturing technology.

Third, the U.S. semiconductor industry continues to invest extensive resources in meeting the rigorous demands of Japan's market. From 1986 to 1989, American chip makers opened more than one new facility in Japan each month to serve the Japanese market. The number of U.S. company personnel during the same period increased nearly 32 percent, and capital expenditures by U.S. companies in Japan rose a remarkable 169 percent. The U.S. semiconductor industry has launched numerous other initiatives to expand sales in Japan. For example, since 1986, the SIA Board of Directors has held one of its quarterly meetings in Tokyo every year. SIA is not aware of any other U.S. trade association that annually meets outside the United States with the objective of increasing

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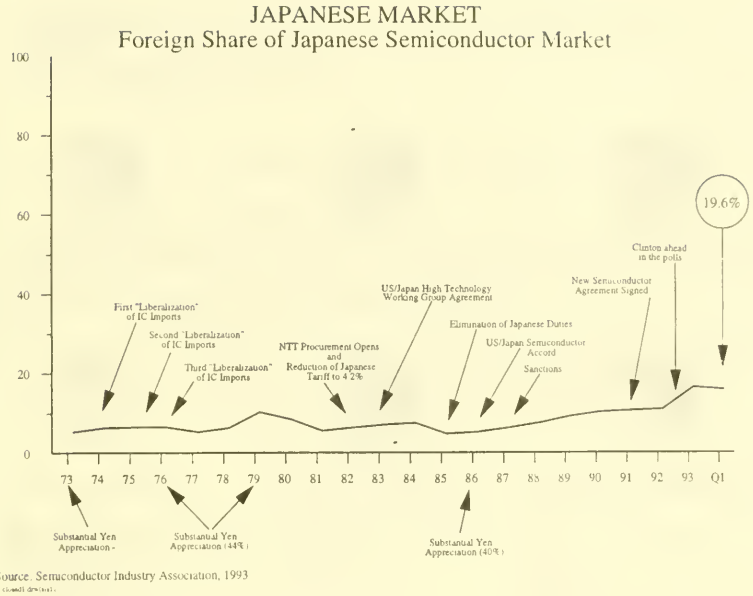
4/USTR, "Review Reveals Insufficient Progress on U.S.-Japan Semiconductor Arrangement," Press Release, August 4, 1992.

exports to a single foreign market. In 1988, SIA opened an office in Tokyo, with initial support from the U.S. Department of Commerce, to coordinate inter-industry contacts, technical tours, trade seminars, and literature exchanges. The office also provides an industry level perspective to supplement individual U.S. company communications to the Japanese government, media, and industry. SIA also has expanded the extensive inter-industry market access program that it developed with the Electronics Industry Association of Japan (EIAJ) under the 1986 Agreement.

In short, the semiconductor pact has worked because the semiconductor industry had a legitimate grievance concerning lack of access to Japan's market; was the market share leader in all world markets outside of Japan; had strong U.S. government support enforcing the Agreement and enforcing measurable progress under that Agreement; continued its efforts to improve competitiveness; won the cooperation of Japanese industry and government; and benefited from an enforced objective benchmark for measuring success. All of these factors have been instrumental in doubling the foreign market share in Japan since 1986.

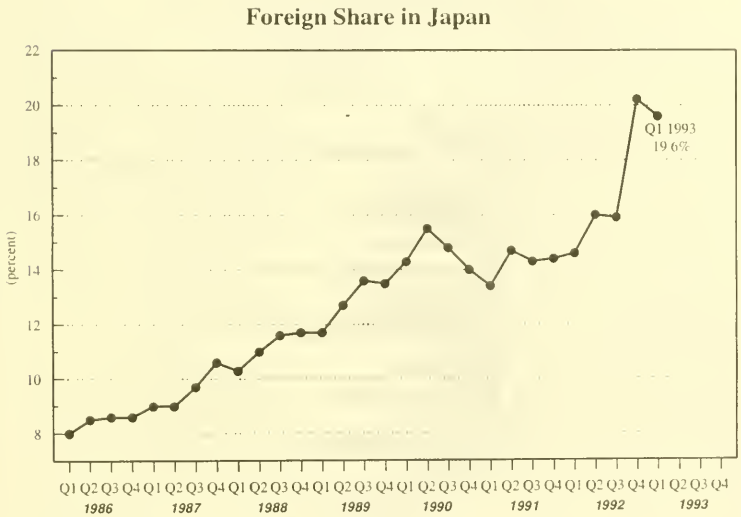
CONCLUSION

SIA supports the Clinton Administration's approach to trade with Japan. If the Semiconductor Agreement is used as a model for trade policy, the lesson to draw is that a complex combination of factors brings success, but success is possible. Both industry and government support for the arrangement and an objective measure, used as a clear benchmark, commensurate with competitiveness, are essential. U.S. trade policy must demand results. It is the hope of SIA that the U.S. government, including this Committee, will continue to support the 1991 Semiconductor Agreement and help ensure continued success. Continued steady progress in market share, moving beyond a minimum 20 percent foreign market share average in 1993 will be critical.



Source. Semiconductor Industry Association, 1993

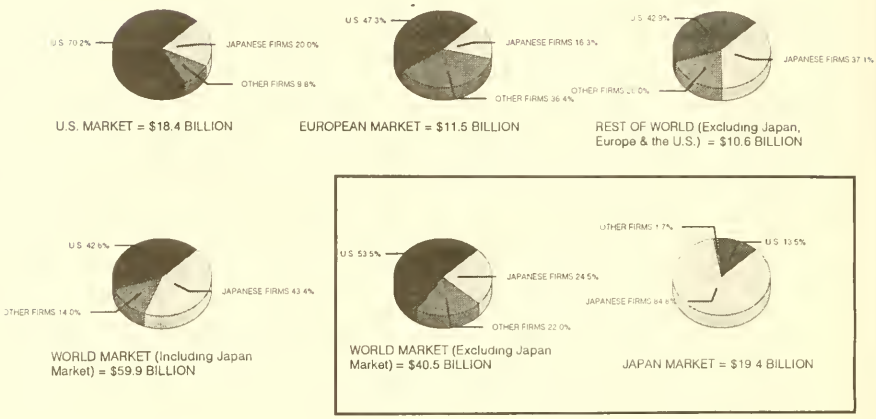
Chart 1



Source 1986-Q2 1991 SIA estimates consistent
Q3 1991-to present U S T R.

Chart 2

U.S. OUTCOMPETES JAPAN IN EVERY OPEN MARKET

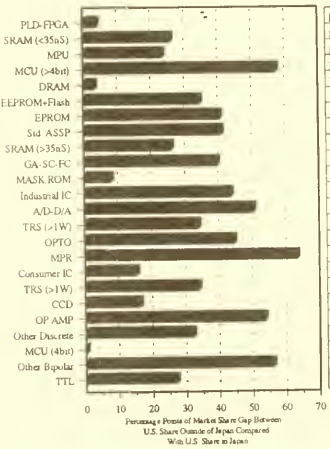


TYPESET\COREL\SEMICOND.CCH

SIA 1992

Chart 3

As Japanese Demand in Individual Products Grows Over the Next Three Years, U.S. and Other Foreign Producers Should Have Many Opportunities to Increase Their Sales to Japanese Users.



Product Growth Rate for 1992-1995

PLD-FPGA	17%
SRAM (<35nS)	15%
MPU	13%
MCU (>4bit)	12%
DRAM	11%
EEPROM+Flash	11%
EPROM	11%
Std. ASSP	11%
SRAM (>35nS)	10%
GA-SC-FC	10%
MASK ROM	10%
Industrial IC	9%
A/D-D/A	7%
TRS (>1W)	7%
OPTO	7%
MPR	6%
Consumer IC	6%
TRS (<1W)	6%
CCD	5%
OP AMP	4%
Other Discrete	4%
MCU (4bit)	4%
Other Bipolar	(4%)
TTL	(12%)

Chart 4

SIA SEMICONDUCTOR INDUSTRY ASSOCIATION
4300 Stevens Creek Boulevard • Suite 271
San Jose • CA 95129 • (408) 246-2711

FAX (408) 246-2830

The Semiconductor Industry Association

Since 1977, the Semiconductor Industry Association (SIA) has represented U.S.-based semiconductor manufacturers -- an industry whose worldwide sales exceeded $21 billion in 1991. SIA member companies comprise 85 percent of U.S. semiconductor production and employ more than 200,000 Americans. The association's primary focus is on international trade, specifically unfair trade practices and increased access for U.S. products in world markets.

SIA activities also include a broad range of industry concerns including: technology policy, occupational safety and health, environmental issues, industry statistics, government semiconductor procurement, and related issues affecting U.S. semiconductor competitiveness.

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Silicon Integrated Systems Corporation
Siltec Corporation
Siltron, Inc.
Technecon Analytical
TSMC, USA
Wacker Siltronic Corporation
WaferScale Integration
Ware and Freidenrich

Chairman GIBBONS. Mr. Morein.

STATEMENT OF JOSEPH A. MOREIN, VICE PRESIDENT, THE CHUBB CORP., WARRENTON, N.J., ON BEHALF OF AMERICAN INSURANCE ASSOCIATION

Mr. MOREIN. Yes, Mr. Chairman.

I am Joseph Morein, vice president of the Chubb Corp., a company with major interests in international property casualty insurance.

Today I am speaking on behalf of the American Insurance Association which represents more than 250 property casualty insurance companies that write over $60 billion in premiums. My purpose today is to explain how United States and other foreign companies seeking to compete in the Japanese property casualty insurance market are subject to barriers similar to those experienced by U.S. industrial companies and those in other parts of the service sector.

Japan is the second largest insurance market in the world. Its nonlife premiums in 1990 totaled $75 billion, the equivalent of one-third of the U.S. property casualty market. It is also a highly profitable market, although it is subject to significant catastrophe exposures, such as typhoons and earthquakes.

The Japanese marketplace is dominated by a small number of very large domestic companies. The top 10 Japanese insurers control 79 percent of the nonlife market. The U.S. equivalent is 30 percent. Similar figures exist for the concentration of the life insurance market.

These large domestic companies are the major beneficiaries of the regulatory system and the unwritten rules. These combine with the keiretsu relationships to create an environment which effectively excludes foreign insurance companies from almost all commercial nonlife coverages.

The Japanese Ministry of Finance regulates the insurance business through an insurance department which reports to a banking bureau. The MOF has only limited capacity available to license new companies or products. It relies heavily on the insurance councils for advice and on various industry associations for self-regulation. Foreign participation in these groups is limited to observer status at best. Many decisions are made with no foreign company input at all.

Product pricing as well as new product introduction is tightly controlled by the MOF, reinforcing the large domestic companies dominant position in the insurance market. These procedures have limited the ability of foreign companies to use product innovation or price competition to gain market share.

While the approach to product development and pricing applies to foreign and Japanese companies alike, there are areas in which foreign companies operate under different rules and market practices, also to their disadvantage.

An example is earthquake coverage. The net effect is that foreign companies have a disproportionate share of earthquake risk compared to the amount of business they write, reducing the attractiveness of the Japanese market to it. We would like to see

earthquake treated on equal basis with the same rules and market practices for all companies in the market.

Informal rules also put foreign companies at a disadvantage. Although there are no explicit prohibitions against foreign acquisition of a Japanese insurer, there has never been such an acquisition.

The MOF is also responsible for product and company classification between life, what they call first division, and nonlife, second division. Some products, such as personal accident, fall into a third division. The products within this third division are of particular importance to foreign insurers. More than 40 percent of foreign insurers' nonlife premiums come from this special category.

Overall, foreign companies' share of the Japanese insurance market remains at less than 3 percent versus the over 12 percent share that foreign companies enjoy in the U.S. market.

The AIA believes that elimination of structural and legal impediments to open competition in the Japanese marketplace will benefit both consumers and insurers. It would greatly enhance our ability to compete, especially in the commercial market. We, therefore, generally welcome the recent recommendations of the Ministry of Finance's Insurance Council regarding the need to liberalize the Japanese insurance market. The report followed three years of deliberations from which the views of foreign firms were largely absent.

From a review of the available materials, it appears that the MOF intends to liberalize the third division as a first priority before addressing the primary life and nonlife sectors. Such a step would be contrary to an open market movement because primary market trading restraints were the factors which effectively forced foreign companies into the third division. The foreign companies' small footholds in the third division were hard won, and this area is more important for them than for the national Japanese companies.

A decision to deregulate the third area in isolation would thus constitute unfair treatment of foreign carriers. It may also force some of these carriers to leave the market. One U.S. insurer has, in fact, recently left Japan, transferring its operations to an Italian company. Another has sold a part interest in its operations to a Japanese life insurer.

We believe that liberalization of the primary nonlife insurance sector should precede liberalization of the third division. We also recommend that deregulation address all current constraints, including policy form approval and rating liberalization.

Further, we suggest that it is important that representatives of foreign insurers in Japan be allowed a more active role in the various industry nonlife committees and the rating associations. Sound mutual benefits will be realized from the input of foreign insurers.

We also believe that a timetable for reform is needed if real progress is to be achieved. This timetable should encompass all the legislative and financial aspects identified in the Insurance Council's report, clarification of the separation of life and nonlife business, a more responsive process for new products, and rating sensitivity.

We applaud the efforts of this subcommittee, and we would like to work with you in the future. Thank you for this opportunity to share the AIA's views on this subject. I would be happy to answer any questions now or later.

[The prepared statement follows:]

TESTIMONY OF JOSEPH A. MOREIN
SUBCOMMITTEE ON TRADE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
JULY 13, 1993

Mr. Chairman, Members of the Subcommittee, Ladies and Gentlemen, good morning. My name is Joseph A. Morein, Vice President of the Chubb Corporation, with major interests in U.S. and international property-casualty insurance. Today I am speaking on behalf of the American Insurance Association on United States-Japan Trade, Commercial, and Economic Relations. The American Insurance Association represents more than 250 property-casualty insurance companies, which write $60 billion in premiums. The AIA is headquartered in Washington, DC and has representatives in every state.

My purpose today is to explain how U.S. and other foreign companies seeking to compete in the Japanese property-casualty insurance market are subject to barriers similar to those experienced by U.S. industrial companies and those in other parts of the service sector.

You may know that Japan is the second largest insurance market in the world. Its non-life premiums in 1990 totalled $75 billion, or the equivalent of approximately one-third of the U.S. property/casualty market. It is also a highly profitable market. However, it is subject to significant catastrophe exposures such as Typhoon Mirelle in 1991 and Tokyo is located in one of the major earthquake zones, about which I will have more to say later.

The Japanese marketplace is dominated by a small number of very large domestic companies. The top ten Japanese insurers control 79% of the non-life market. (The U.S. equivalent is 30%.) These large domestic Japanese companies are the major beneficiaries of the regulatory system, as well as a set of unwritten rules. These, combined with the "Keiretsu" and/or cross-shareholding relationships, create an environment which effectively excludes foreign insurance companies from competing in almost all commercial non-life coverages.

The Japanese Ministry of Finance (MOF) regulates the insurance business through an insurance department which reports to a banking bureau. The MOF has only limited capacity available to license new companies or products. It relies heavily on the insurance councils for advice (i.e. which are dominated by Japanese companies), and on various industry associations for self- regulation. Foreign participation in these groups is currently limited to observer

status. Many decisions are made with no foreign company input at all.

Product pricing as well as new product introduction is tightly controlled by the MOF, thus reinforcing the large domestic companies dominant position in the insurance market. These procedures have limited the ability of foreign companies to use product innovation or price competition as ways to gain market share.

While the approach to product development and pricing applies to foreign and Japanese companies alike, there are areas in which foreign companies operate under different rules and market practices, once again to their disadvantage. An example is earthquake coverage. For commercial risks, the Japanese companies have agreed to restrict their coverage to 15% of value. Foreign firms do not have this constraint. As a result, market pressures result in their taking on a disproportionate share of earthquake risk.

A further inequality in the earthquake area exists in the area of personal homeowners coverage. Earthquake coverage on the homes of Japanese citizens has low limits and has access to a reinsurance pool. Coverages for foreigners living in Japan do not have the limit constraint and may not be reinsured into the earthquake pool. Not surprisingly it is companies like Chubb that end up providing protection for these expatriates.

The net effect is that foreign companies have a disproportionate share of earthquake risk, reducing the attractiveness of the Japanese market. We would like to see earthquake treated on an equal basis, with the same rules and market practices for all companies in the market.

We would not argue that the U.S. insurance regulatory system is perfect. It has many shortcomings. However, it does provide a fairly level playing field for foreign and domestic companies and we feel that is not the case in Japan.

Informal rules also put foreign companies at a disadvantage. Although there is no explicit prohibition against foreign acquisition of a Japanese insurer, however there has never been one. While we are not necessarily in the market to buy a Japanese insurer, we would like to have the option, as Japanese companies have in the United States.

The MOF is also responsible for product and company classification between life ("first division") and non-life ("second division"). Some products (e.g., personal accident, disability and medical supplements) fall into a "third division." The products within this "third division" are of particular

importance to foreign insurers. More than 40% of foreign insurers' non-life premiums come from this special category.

Various structural barriers have proven almost insurmountable to foreign companies. After twenty years of serious efforts, foreign companies' share of the Japanese insurance market remains at less than 3%, versus the over 12% share that foreign companies enjoy in the U.S. market.

AIA believes that the elimination of structural and legal impediments to open competition in the Japanese marketplace would be a very positive step that will benefit both consumers and insurers. It would greatly enhance our ability to compete, especially in the commercial market. We therefore generally welcome the recent recommendations of the MOF's Insurance Council regarding the need to reform and liberalize the Japanese insurance market. The report followed three years of deliberations which virtually excluded the views of foreign firms. The MOF is now preparing to implement the Council's recommendations over the next three years. Some reforms can be carried out by MOF alone, some will require new legislation by the Diet. However, consistent with the spirit of openness espoused by the Insurance Council's Report, AIA respectfully draws official attention to its concerns.

Based on our review of all available materials, it appears that the MOF intends to liberalize the "third division" as a first priority, before addressing the primary life and non-life sectors. Such a step would be contrary to an open market movement because primary market trading restraints were the factors which effectively forced foreign companies into the "third division." Foreign companies' small foothole in the "third division" were hard won, and this third area is more important for them than for the national Japanese companies. Thus, a decision to deregulate the third area in isolation would constitute unfair treatment of foreign carriers. It could also force some of those carriers to leave the market. One U.S. insurer has in fact recently left Japan, transferring its operations to an Italian company. Another has sold a part interest in its operations to a Japanese life insurer.

We believe that liberalization of the primary non-life insurance sector should precede liberalization of the "third division" for the mutual benefit of insurance consumers and the insurance industry. We also recommend that deregulation address all current constraints including policy form approval and rating liberalization.

Because deregulation is being driven to some extent by international developments, we suggest that it is important that representatives of foreign insurers in Japan be allowed a more active role in the various industry non-life committees and the

rating associations. Legislative and regulatory changes should be the product of due process, including some form of notice and reasonable period for comment. Sound mutual benefits will be realized from the input of foreign insurers.

We also believe that a timetable for reform is needed, if real progress is to be achieved. This timetable should encompass all the legislative and financial aspects identified in the Insurance Council's Report, clarification of the separation of life and non-life business, a more responsive and accelerated process for new products, and rating sensitivity.

As is demonstrable in many other world markets, a mixture of direct selling and broker placements within the same market can function harmoniously and beneficially. Therefore, the absence of brokers from the Japanese marketplace may be incompatible with the internationalization of that market and impede some of the developments favored by the Insurance Council. We support the Council's recommendation for a study on introduction of a broker system.

AIA hopes that its testimony to the Subcommittee will assist in their deliberations on Japan. As an insurance organization with an interest in the global marketplace, we want to play a role in facilitating the process of market liberalization. It is clear from the Insurance Council's Report that the Japanese have a collective will for constructive deregulation. We recognize that the nature of the present Japanese marketplace makes the implementation of the reforms a challenging assignment. I am submitting a copy of the Insurance Council's Report for the Subcommittee's record.

I would also like to use this opportunity to make some brief remarks on the importance of the U.S. Financial Services Sector. The need for strong bilateral and multilateral trade agreements for service is supported by the economic data on the U.S. service sector. In the United States, the service sector is the fastest growing component of the economy, employing over 77 percent of the workforce, accounting for nine out of ten new jobs, producing almost 70 percent of GDP, and one-third of total United States exports. Every state has more people employed in service jobs than in manufacturing, agriculture, or mining.

There are tens of millions of people employed in such industries as banking, telecommunications, health care, data processing, advertising, accounting, insurance, transportation, and tourism, to name a few.

From a global perspective, we are the leader in services trade. Services exports from the U.S. have grown steadily over the past several years, from $77 billion in 1986 to $167 billion in

1992 - an increase of 116 percent. What we call the "private services balance" has been in surplus for over 20 years, and reached a record high of $59 billion in 1992, significantly offsetting the merchandise trade deficit of $96 billion. To focus solely on the merchandise trade deficit is misleading on a balance of payments argument because it excludes the services trade surplus.

According to the GATT Secretariat, the United States exports more services than any other single country. We can only maintain this advantage through a strong and fair global trading system.

AIA applauds the efforts of this Subcommittee and we would like to work with you in the future. Thank you for this opportunity to share AIA's views on this significant subject.

I would be glad to answer any questions you may have.

[An attachment to this statement is being retained in the committee files]

Chairman GIBBONS. Mr. Kadrich.

STATEMENT OF LEE KADRICH, DIRECTOR OF GOVERNMENT AFFAIRS AND INTERNATIONAL TRADE, AUTOMOTIVE PARTS & ACCESSORIES ASSOCIATION

Mr. KADRICH. Thank you, Mr. Chairman.

The APAA welcomes this opportunity to voice our strong support for President Clinton's results-oriented negotiating approach and the framework agreement he has secured to allow new auto parts talks to proceed.

As the world's high quality, low cost automotive supplier base, we believe our sector's priority status will provide a big payback in terms of increased U.S. production both to offset imported parts and to expand parts exports.

Given the economic factors favoring American suppliers, we are seeing sales increasing, albeit nowhere near levels commensurate with U.S. competitiveness. Brisk levels of design-in activity and heightened prospects of engineered U.S.-made parts being included in future Japanese models have appeared since President Bush's 1992 trip, spurred by steady pressure from Congress and the early efforts by Ambassador Kantor and Secretary Brown to hold Japan accountable to its 1994 goals.

However, Mr. Chairman, a new report issued by the Japan Automobile Manufacturers Association—JAMA—itself forewarns against celebrating additional sales gains too soon. While acknowledging our industry's cost, quality, and delivery competitiveness, Japanese OEMs have added a new capabilities gap as their latest excuse for the very scant 26 percent parts sourcing share of transplant purchases held by non-Japanese-owned U.S. parts suppliers.

We applaud the administration's steps to retake control of the trade agenda and to begin Japanese market opening steps right here at home.

We agree with our negotiators' interpretation of the objective criteria provided for in the framework as the measure of progress. The only objective gauge of how far the market opening door swings open requires a measurement in terms of new sales by non-Japanese-owned U.S. suppliers. JAMA's current 26 percent United States sourcing figure would offer the ideal baseline against which we could measure new sales progress.

Without such critical focus on results, Japan will continue to send both their home suppliers and their exclusionary practices into our market, dislocating our suppliers and running up the scoreboard, if you will, with vast, so-called U.S. parts purchases from their Japanese parts partners and expecting plaudits for doing so. The United States cannot allow this distortion to continue.

Let me highlight key elements of the successful outcome that we are seeking:

First, the United States should continue insisting that the Japanese OEMs meet the 70 percent U.S. content goal, measured as a percentage of total parts sourcing. The $15 billion 1994 parts purchase goal that the Japanese offered President Bush is tied in turn to that content goal.

Second, U.S. industry and Government should work together to raise that 70 percent goal in future years.

Third, the University of Michigan methodology, which I have attached to my testimony, should be used to track the progress of non-Japanese-owned U.S. suppliers on a system-by-system basis in moving from the 26 percent JAMA-cited figure toward that 70 percent figure.

That same method might be used to chart growth of our parts exports to Japan where we have less than 1 percent market share.

Qualitative indexes will also need to be developed to give Japan credit for design-in commitments and planned U.S. purchases for future model production.

Fourth, although Japan's 1994 sourcing goal said nothing about aftermarket purchases for Japanese car dealership's service purposes, the steps I have mentioned above have the potential to parlay OE sales opportunities into additional aftermarket sales opportunities.

In addition, the United States industry and Government should work on some specific targets or goals for aftermarket purchases.

Fifth, we believe that the key objective and ultimate measure of the market opening progress will be the rapid reduction of the massive parts trade deficit to levels reflective of our global competitiveness.

We have waited a long time for this new negotiating approach to deal with the bilateral parts trade crisis, and we now look forward to working with the Congress and the administration toward a pro-competition outcome.

Thank you, sir.

[The prepared statement and attachment follow:]

TESTIMONY OF LEE KADRICH, DIRECTOR GOVERNMENT AFFAIRS & INTERNATIONAL TRADE FOR THE AUTOMOTIVE PARTS & ACCESSORIES ASSOCIATION PRESENTED TO THE SUBCOMMITTEE ON TRADE UNITED STATES HOUSE OF REPRESENTATIVES JULY 13, 1993

Mr. Chairman and Members of the Subcommittee:

APAA welcomes this opportunity to voice our strong support for President Clinton's results-oriented negotiating approach and the framework agreement he has secured to allow new auto parts talks to proceed. The President's bold new approach is needed to end unfair Japanese parts trade practices blocking U.S. global sales, dislocating U.S. owned suppliers and their workers, creating massive parts trade deficits, and threatening both our economic recovery and future.

As the world's high quality, low cost automotive supplier base, we believe our sector's priority status will provide big paybacks in terms of increased U.S. parts production both to offset imports and for expanded U.S. exports.

Given fair market access, our industry's vast proven competitive advantage over Japan-based competitors should result in a U.S. trade surplus, rather than the $10 billion plus parts deficit that accounts for 20% of the total deficit with Japan.

We commend our negotiators for standing firm on demands that the framework agreement focus on results. The Administration team has worked closely with our industry and we look forward to shaping a set of market-based targets which we as a nation would consider a successful outcome for future auto parts negotiations.

Japan resists this approach as managed trade. But, for the past twelve years Japan in effect has managed the trade agenda on auto parts to the U.S. detriment, and forestalled any cracks in the structural barriers created by Japan's anticompetitive auto maker/supplier families, or keiretsus, that generally exclude outside competitors. The ten-fold explosion in the trade deficit from 1980 to 1992 is the benchmark of their success.

The replication of these same exclusionary market barriers in the U.S. by transplanted car assemblers and more than 400 related Japanese suppliers (to date) has its own set of nonmarket-based results: displaced Big Three nameplates, dislocated original equipment

(OE) parts makers and their workers and decimated markets for U.S. replacement parts. Both transplant car makers and their Japanese suppliers here continue to rely heavily on imports from Japan.

Given the sheer weight of economic forces favoring American suppliers, we see sales increasing, albeit nowhere near levels commensurate with U.S. competitiveness. Brisk levels of design-in activity and heightened prospects of engineered U.S.-made parts being included in future models have appeared since President Bush's 1992 trip, spurred by steady pressure from Congress and the early efforts by Ambassador Kantor and Secretary Brown to hold Japan accountable to its avowed 1994 sourcing goals.

However, Mr. Chairman, a new report issued by the Japan Automobile Manufacturers Association (JAMA) itself forewarns against celebrating additional sales gains too soon. While acknowledging our industry's cost, quality and delivery competitiveness, Japanese OEMs have added a new "capabilities gap" as their latest excuse for the scant 26% parts sourcing share of transplant purchases held by non-Japanese owned U.S. suppliers in 1992.

APAA applauds the Administration's steps to retake control of the trade agenda and to begin Japanese market opening right here at home.

We agree with our negotiators' interpretation of "objective criteria" provided for in the framework as the measure of progress. The only objective gauge of how far the market door swings open requires measurements in terms of new sales by non-Japanese owned U.S. suppliers. JAMA's current 26% U.S. sourcing figure provides the ideal baseline to measure genuine U.S. sales progress.

Without such critical focus on results, Japan will continue to send their home suppliers and exclusionary practices here, dislocate U.S. suppliers, run up the scoreboard with vast "U.S. parts" purchases from their Japanese parts partners and expect plaudits for doing so. The U.S. cannot allow this distortion to continue.

Let me highlight key elements of the successful outcome APAA seeks:

(1) The U.S. should continue insisting that Japanese OEMs meet the crucial 70% U.S. content goal, measured as a percentage of total parts sourcing. The $15 billion parts purchase goal for the U.S. market is tied in turn to this 70% content level.

(2) The Administration and U.S. industry should work jointly to raise the 70% U.S. content number for 1995 and beyond.

(3) The University of Michigan methodology (See Appendix 1) should be used to track progress of non-Japanese owned suppliers on a system-by-system basis in moving from the 26% JAMA-cited share in 1992 towards the 70% 1994 goal. The same method should be applied to gauging non-Japanese owned suppliers' success in cracking Japan's home OE

parts markets, where U.S. exports now hold less than 1% market share. Qualitative indices should be developed to ensure Japanese OEMs get credit for design-in commitments and planned U.S. purchases for future model production.

(4) Although Japan's 1994 sourcing goals included no specific aftermarket parts buying targets, the above steps have the potential to parlay OE sales into global aftermarket opportunities. In addition, U.S. industry and negotiators should develop targets for the rapidly growing Japanese dealer network service parts markets in the U.S., as well as setting benchmarks for Japan's aftermarket.

(5) APAA believes the key objective and ultimate measure of market opening success will be the rapid reduction of the massive parts trade deficit to levels reflective of our global competitiveness.

In support of the negotiations, APAA urges passage of Sen. Riegle's Fair Trade In Motor Vehicle Parts Act which provides mandated Sec. 301 and antidumping cases as an effective backstop to the negotiations.

We seek extension and enhancement of the Fair Trade in Auto Parts Act scheduled to expire this year. An interagency role should be included, and U.S. trade, trust and tax policies must be marshalled to enforce our pro-competition system's rules and stamp out Japan's unfair trade practices here.

Finally, as a vital part of long term enforcement, APAA urges enactment of Super 301 restoration legislation and the Trade Agreements Compliance Act to enforce the first concrete Japanese parts trade agreement.

We have waited many years for the U.S. to adopt a results-oriented strategy to deal with this bilateral parts trade crisis and now look forward to working with the Administration and Congress in pressing for a pro-competition outcome.

Table 16
Transplant Sourcing Case Study
Summary Results

System	Import Sourced	Transplant Sourced	Traditional Domestic Sourced
Engine	58%	37%	5%
Transmission	62%	29%	9%
Engine/Emission Control	41%	39%	21%
Body	45%	46%	10%
Comfort/Convenience	58%	17%	25%
Suspension/Steering	60%	20%	20%
Glass	42%	15%	43%
Hardware	45%	9%	45%
Interior Hard/Soft Trim	22%	45%	33%
Brakes/Wheels/Tires	28%	37%	35%
Other Parts	47%	24%	29%
Other, not elsewhere	42%	31%	27%
Percentage of Total Components (based on $8,030)	48%	33%	20%
Total Components per Vehicle (based on $8,030)	$3,820	$2,625	$1,585
Percentage of Total Vehicle—Including Assembly (based on $10,030)	38%	46%	16%
Total Value per Vehicle	$3,820	$4,625	$1,585

Applying these percentages to our estimated $10,030, we estimate $3,820 of import parts value per transplant produced, with $4,625 contributed from transplant facilities (including wholely-owned and joint-venture facilities) and $1,585 from traditional domestic suppliers.

Scanning the systems, it is apparent that domestic suppliers are generally underrepresented in the three major vehicle systems: engine, transmission, and body structure. By our estimates, these systems have about $3,300 (33% of total) of value. The most significant systems inroads by the domestics—hardware, glass, brakes/wheels/tires, and interior hard and soft trim—have approximately $1,400 (14% of total) of value. This substantiates domestic supplier concerns through this transition period of Japanese production globalization. Japanese vehicle manufacturer component sourcing strategies to date have not

Chairman GIBBONS. Let me ask all the panel members, is the administration, in your view, on the right track?

Mr. KADRICH. We think so, absolutely. This is a market-opening pro-competition approach. We agree that the effect of reforming Japanese procurement practices will be beneficial to competitive suppliers of any national origin. Once the structural barriers are removed, there will be improved access for all suppliers.

Mr. BRENNER. We also think they are absolutely on the right track. I think several people have taken their hats off to the negotiating team that was in Tokyo last week. And considering where they started only a week prior to that, I think they came an awful long way.

The results we will only know when the cash register rings, when we see market share in Japan significantly increasing, when we see sales increasing, but as a rule book, as Ambassador Kantor pointed out, this framework appears to be in that category.

The thing about this administration that has impressed me in the business sense is that they are united. The Defense Department, the State Department, the USTR, Department of Commerce came across to the Japanese with a united front, so that previous negotiating tactics which the Japanese have used when the USTR got too tough and then went to State Department to complain I don't think are going to occur in this administration.

For that reason almost by itself I think the administration is on the right track.

Mr. MOREIN. I think we are encouraged that services—financial services are being mentioned, but there is obviously a substantial way to go.

Mr. WOLFF. I would just add that I believe they certainly are on the right track. It is a very sophisticated approach. I think it learns from past errors.

We always say the Japanese have a long memory. They have an institutional memory. They are able to deal with these problems year in and year out in a way the U.S. Government isn't.

This team looks like they have really learned the lessons of the past. They are approaching this as a macroeconomic issue, structural issue, as well as a sectorial issue. I think it promises to have a fair degree of success if anything can.

Chairman GIBBONS. Ambassador Wolf, looking back on your vast experience in this area, what has been wrong with U.S. policy? This United States-Japan relationship has ended up being such a frustrating one. Why have we not been able to solve our problems with Japan?

Mr. WOLFF. I think that in part we have been naive, that we always felt that all countries' economies function in the same way, and they don't. We didn't understand the layers of problems and areas in Japan. We had some evidence of it, but in part our academic community is still, I think, behind the curve to a large extent.

The new book by Fred Bergsten is a refreshing example of the break from traditional economic analysis that said there was no problem. Businessmen would come back, and they would say, can't sell there, but the economists would say, that is pretty much the

overall balance you would expect given a number of macroeconomic factors.

The analysis was wrong. The approach was not hardheaded enough. We didn't insist on results early enough. We didn't work as closely in the Government with the business community as we should have.

Years ago we thought that the tariffs were the main barrier, and they were to some degree in some areas. When we stripped away the tariffs we found a variety of nontariff barriers. We still can't sell a lot of competitive products in Japan, and we have not invested the resources in it that we should have.

We will put thousands of people to work on environmental protection in this country. It is a worthy objective. And we have thousands and thousands of people working at the customs booths on the way into this country. Yet we have not put the people that we need—the resources we need to put into solving some of these market access problems.

Each of the sectors that have appeared before you today and on other occasions require probably two or three people at a bare minimum in the Government who have no other job but to make sure we make some progress.

I might add Mr. Brenner's comment on the historic division in the U.S. Government has been largely the case. We had a period in the Carter administration where we certainly overcame that, and Fred Bergsten was on the team that we put together to work on it. And State was with us, Treasury was with us, but most often there has been a division, and the Embassy has been an apologist for Japan all too often in the past. I don't think we will see that with Fritz Mondale.

So I think we are finally probably overcoming a lot of the things that we did wrong in the past. I think the Japanese are beginning to sense that.

Chairman GIBBONS. Well, in the limited amount of time we have available, do any of you have any comments on what Ambassador Wolff has said?

Mr. KADRICH. I would like to say I really agree with his analysis. I see all of the signs that he has indicated as major improvements and good signposts for the potential progress ahead in these negotiations.

Chairman GIBBONS. I would like to thank all the witnesses who participated in today's hearing, particularly the members of this last panel, who have been so patient.

The submission of written statements for printing in the record will be accepted until the close of business on Monday, July 19. That concludes our hearing for today. Thank you very much.

[Whereupon, at 12:50 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

AMERICAN INTERNATIONAL AUTOMOBILE DEALERS ASSOCIATION
99 Canal Center Plaza, Suite 500, Alexandria, VA 22314
703/519-7800

Statement submitted to the
House Ways and Means Committee,
Trade Subcommittee

Hearing on U.S.-Japan Trade, Commercial and Economic Relations
July 13, 1993

This statement by the American International Automobile Dealers Association (AIADA) to the House Ways and Means Committee, Trade Subcommittee, presents AIADA's views on the U.S.-Japan trade relationship and the Clinton Administration's trade policy toward Japan. AIADA represents 10,000 American small businesses that sell and service international automobiles and employ more than 280,000 Americans.

AIADA believes that pursuit of the most open market/free trade policies is in the best interest of the U.S. economy, U.S. industries and U.S. consumers. Previous pursuit of those policies has been instrumental in improving U.S. international competitiveness and in providing consumers with a greater selection of products at lower prices. The situation is no different in the automobile industry.

The Clinton Administration has recently taken great strides regarding U.S.-Japan relations. AIADA supports the Administration in seeking to negotiate trade agreements with our trading partners. Moreover, the recent Tokyo Accord represents a significant, positive step forward in our trade relationship with Japan. Because of this, AIADA believes any legislative action on this issue could undermine the recent "framework" agreement and further jeopardize our trading relationship with all of our international trading partners. In that context, it is very critical that the Administration's negotiators have a free hand in their work, not only with Japan, but with all nations.

Moreover, it is not sound economic or trade policy to single out one industry in one nation for legislative action. While the trade imbalance between the United States and Japan in automobiles continues to be large, it is critical to examine this trade imbalance in the proper context.

A Massive Transfer Of Industrial Production

Over the past decade, dramatic change has taken place in the U.S. automobile industry. While the Big Three automakers have shifted automobile assembly production from the U.S. to Canada and Mexico, international automobile manufacturers have shifted production to the U.S. — investing almost $10 billion in U.S. assembly plants and related facilities. A total of seven Japanese motor vehicle manufacturers have transferred production of cars and trucks from Japan to the U.S., while two German manufacturers will begin producing vehicles in the U.S. in the near future.

In the early 1980's, at the urging the United Auto Workers union, the Big Three automakers and their supporters in Congress, Japanese automakers began a massive transfer of industrial production from Japan to the U.S. Honda, the first Japanese automakers to build in the U.S., began automobile production in Marysville, Ohio, in 1983. In 1986, imports of motor vehicles from Japan peaked, declining in numbers every year since then. In that year, Japanese companies exported approximately 2.9 million cars, multipurpose passenger vehicles and trucks to the U.S., while producing more than 600,000 motor vehicles in the U.S.

By the mid-1990's, U.S. production of Japanese motor vehicles will exceed the number of vehicles imported from Japan. In 1992, U.S. production of motor vehicles by Japanese companies, including those made for the Big Three automakers, totalled 1.68 million units, while the number of motor vehicles imported from Japan has dropped nearly 50 percent from the peak year in 1986 to approximately 1.74 million units last year.

Auto Parts Procurement

With the shift in automobile production from Japan to the U.S. came an increase in purchases of U.S.-made automobile parts by Japanese automakers. Critics of the Japanese automakers contend that they do not buy enough parts from "traditional" U.S. suppliers for their U.S. production and rely too heavily on Japanese auto parts imports or so-called transplant auto parts makers.

The fact is that purchases of U.S.-made auto parts and materials by Japanese automakers have increased steadily over the past few years — from $2.49 billion in Japanese fiscal year (JFY) 1986 to a total of $10.53 billion in JFY1991. Japanese automakers announced in January 1992 that, collectively, they plan to purchase $19 billion in U.S. parts and materials by 1996 and it appears that they are on schedule to meet that goal. While Japanese automakers are making efforts to purchase more U.S.-made parts, long-term supplier relationships that meet the high quality and delivery standards of Japanese automobile manufacturers can take years to develop.

With respect to the concerns that "traditional" parts manufacturers are not receiving enough business from Japanese automobile manufacturers, there are two points to be made. First, if the parts manufacturer is creating U.S. manufacturing jobs, the nationality of the ownership of that parts manufacturer is irrelevant. Second, any attempt to define a "traditional" parts manufacturer in the automobile industry, where joint ventures are commonplace, would be arbitrary and likely discriminate against foreign investment.

U.S. Benefits From Transplant Production

As stated above, international automobile manufacturers have invested nearly $10 billion in the U.S. to build automobile assembly plants, research and development centers, design centers, testing facilities and other operations to support their U.S. production.

This enormous investment in the U.S. has yielded more than 35,000 American manufacturing jobs in automobile production alone. More than 10,000 dealerships across the country sell and service international automobiles, employing nearly 280,000 Americans. Including other related employment such as sales offices and automobile parts production, the international automobile industry employed more than 400,000 Americans in 1992.

Taken in the context of the Big Three automakers' manufacturing presence in the U.S., international automobile manufacturers are now the second largest car-maker in the U.S. behind General Motors, building one out of every four cars.

Another benefit of international automobile manufacturers' production in the U.S. has been the increase in U.S. automobile exports, particularly to Japan. Exports of international automobile manufacturers rose to 158,000 in 1992. Japanese automakers exported more than 23,000 American-made cars to Japan in 1992, helping reduce the U.S. automobile trade deficit with Japan.

Exports of international nameplate automobiles are expected to increase over the next few years. This will come as a result of increases in exports of Japanese nameplate vehicles and as production of BMW and Mercedes-Benz comes on-line. BMW has announced it will export approximately half of its production in South Carolina. Mercedes-Benz is expected to export a portion of its U.S. production as well.

Japan's Automobile Market And The Big Three

The association accepts the assertion that Japan's market, including its market in automobiles, has not been as open as it should be if Japan is to compete fairly in a global free market trading system. However, Japan has taken steps to open its market to U.S. automobiles, including the elimination of tariffs on cars and trucks and expanding sales opportunities for U.S.-made automobiles at Japanese dealerships.

While it is clear that Japan's market has not been as open as it should have been in the past, it is equally clear that the Big Three U.S. automakers have not made the necessary commitment to expand automobile sales in Japan. Only recently have Big Three automakers taken steps to export right-hand drive vehicles to Japan, where driving on the left-hand side of the road makes left-hand drive vehicles impractical.

And the Big Three still ignore the needs and desires of Japanese consumers. In Japan, where roads are narrower, parking is scarce and gasoline is twice as expensive, consumers want compact, fuel-efficient vehicles. Cadillacs, Lincolns and Jeep Cherokees are not likely to become the mass-selling vehicles that are necessary if the Big Three are to gain a greater share of the Japanese market.

In contrast to the efforts of the Big Three to penetrate the Japanese market, Japanese automakers made adjustments to build for the U.S. market when the vehicles they first imported did not sell well. Today, high-volume automobiles (e.g., Honda Accord, Toyota Camry, Nissan Altima, etc.) sold by the Japanese automakers in the U.S. market are designed and built in the U.S. to meet the needs and tastes of American consumers.

Foreign Automakers' Marketshare In Japan

The Big Three automakers complain that the Japanese market is still closed to their products, basing this assertion on the fact that sales of their vehicles are less than one-percent of the total Japanese market and sales of all foreign vehicles are only four percent of the total market.

A comparison of European automakers' marketshare in Japan and their marketshare in the U.S. reveals that the Japanese market may not be as closed to imports as the Big Three claim, and that the real problem may lie more with Big Three marketing, the quality/reliability of their automobiles and their commitment to the Japanese market. European automakers hold approximately three percent of the total market in Japan and four percent of the market in the U.S.

Demand For Japanese Automobiles

It is very unlikely that the Japanese trade deficit (two-thirds of which is in automobile trade) will be eliminated in a matter of a few years as has been called for by the Big Three automakers.

Despite the reduction in the number of vehicles imported from Japan and the increase in the number of Japanese vehicles made in the U.S., Japanese automakers can be expected to import low volume vehicles into the foreseeable future.

Demand for Japanese automobiles, while diminished recently due to exchange rate-induced price increases, will remain strong. The quality of Japanese nameplate automobiles, whether imported or built in the U.S, still exceeds that of the Big Three. The 1993 J.D. Power New Car and Light Truck Customer Satisfaction study, which assesses customer handling and vehicle repair/reliability, showed that, while the Big Three automakers have closed the quality gap somewhat, the Japanese car nameplates "continue to set the pace in customer satisfaction."

It should be noted that Big Three sales have increased constantly since the beginning of the year, this despite a decline in consumer confidence in the economy's health. The growth in sales is thought to be the result of the lower interest rates and for the need to replace automobiles purchased in the early 1980s.

Furthermore, it is unlikely that, in the next five years, exports of Big Three automobiles will increase in sufficient numbers to balance automobile trade with Japan. As stated before, the Big Three have no large-volume vehicles designed for the needs and desires of the Japanese consumer.

Dollar-Yen Exchange Rate

Since U.S. trade data are expressed in dollar terms, two key points need to be kept in mind when reviewing year-to-year statistics. First, the dynamic of exchange rate fluctuations affect product prices. The weakening of the dollar against the yen has made Japanese automobiles more expensive for Americans. This can hardly be blamed on the manufacturers who have no control over such matters.

Second, since 1979, the price of cars has increased dramatically due to three factors. The Yen is half of what it was in 1979. The rapid development of the luxury car segment has accounted for a large part of higher overall prices. And, the 1980s saw rapid price escalation for all makes, increased in some measure due in part to the imposition of Japan's voluntary export restraints (VERs). Thus the use of any sample number needs to be placed in the proper context.

International Trade Is Not A Zero-Sum Game

Focusing on the U.S.-Japan trade deficit in motor vehicles with the expectation that the automobile trade deficit will balance in a few short years is to view international trade as a zero-sum game.

But international trade should not and does not work in that manner. In the international trading system, each nation has its own comparative advantages. For example, Japan has a comparative advantage in automobiles, Costa Rica has a comparative advantage in bananas, and the U.S. has a comparative advantage in commercial jet aircraft.

While we consistently maintain a trade deficit in bananas with Costa Rica ($25 million in 1992, to be precise), there have been no demands that Costa Rica eliminate its trade surplus in bananas with the U.S. in five years. In the same manner, the U.S. should not expect Japan's trade surplus in automobiles and automobile parts to be eliminated in five years.

Recent U.S. Merchandise Trade data (May 1993) reflects a hefty $1.8 billion decline in the deficit. In the "Automotive vehicles, parts & engines" category, the decrease in imported product is $572.8 million. In fact, Japan now trails Canada in auto exports to the United States.

Trade Expansion With Japan

The Clinton Administration and Congress should not hold expectations that there will be an elimination of the trade imbalance in automobiles with Japan. Such expectations may lead to further frustration with Japan, increase the threat of confrontation and, eventually, lead to U.S. retaliation against Japan.

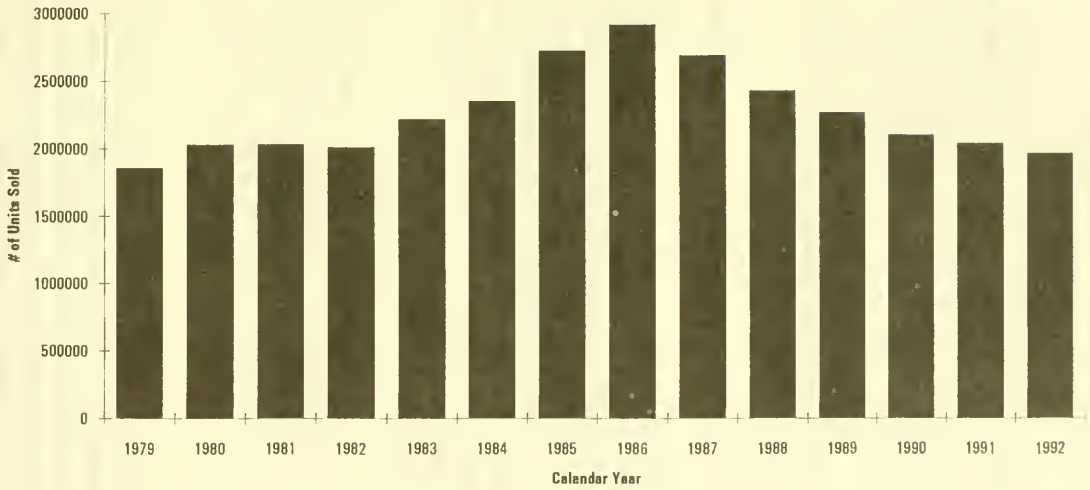
Instead, the energy and attention of the administration's negotiators should be directed to other markets that may hold great prospect for sales of U.S. manufactured and agricultural products and for U.S. services industry.

Conclusion

AIADA believes that the globalization of the automobile industry has brought many benefits to the U.S., including increased job creation in the U.S. and higher-quality, lower-cost automobiles for the American consumer.

AIADA also believes that while Japan's trade surplus with the U.S. in automobiles and automobile parts is decreasing significantly, it is not likely to be eliminated in the near future. However, viewed in context, this trade imbalance does not pose a problem for the U.S. economy or for the U.S. job market.

Japanese Import Car and Light Truck Sales 1979 - 1992



Souce: Ward's Automotive Reports

TESTIMONY OF THE ASSOCIATION OF INTERNATIONAL AUTOMOBILE MANUFACTURERS, INC.

The Association of International Automobile Manufacturers (AIAM) is a trade association representing the U.S. subsidiaries of almost every international automobile company. Our members engage in different levels of sourcing, manufacturing, distribution, and sales of passenger cars, multi-purpose passenger vehicles (MPVs), and light trucks in the United States. 400,000 Americans are involved in the manufacturing, research and development, transportation, distribution, sales, and service operations of AIAM members. In addition to these car makers, AIAM also represents manufacturers of original equipment with production facilities both here in the United States and abroad.

AIAM appreciates the opportunity to submit this statement for the record.

AIAM's members contribute to the strength of the U.S. economy. Nissan has the largest auto plant under one roof in the United States. Toyota, Honda, Mazda, Isuzu, Subaru, and Mitsubishi also have extensive operations which will only grow as they continue to mature. In 1995, BMW will open its $300 million facility in South Carolina, becoming the eighth member to produce vehicles in America. Even without manufacturing facilities, a number of our European and Korean members employ thousands of Americans who design, procure, distribute, and sell cars which offer American consumers a variety of choices of price, fuel economy, safety, design, and performance.

AIAM is proud of the combined contributions of all of its members, whether their parent companies are from Europe or Asia. This statement, however, will focus on the particular contributions of our Japanese-owned members to the U.S. economy, as U.S.-Japan trade, economic, and commercial relations are the topic of this hearing.

As stated in the hearing notice, a significant portion of the complex U.S.-Japan relationship involves trade, economic, and commercial relations. As an association of international companies in one of the more hotly debated sectors in the U.S.-Japan relationship, AIAM will address the internationalization of the automotive sector and the contributions of bilateral investment in this sector. The Association believes it is important to remember, as the Subcommittee has done, that trade alone does not describe the full extent of this important relationship and should not bear the full burden of resolving the inherent tensions between the two countries. AIAM member companies certainly are a part of the trading relationship between the two countries, but their greatest contribution to the U.S. economy -- and as a result, to the American worker and consumer -- is their investment in the future of the American industrial and technological base, their transfer of production techniques and other technological advancements to this country, their enhancement of the quality and the variety of safe, efficient vehicles for American consumers to choose.

Internationalization of U.S. Auto Industry

The United States trade deficit in motor vehicles has been reduced by 27 percent since 1987 (according to the most recent Department of Commerce figures). Yet, Japanese auto makers remain a focus of bilateral trade tensions. In announcing this hearing your Committee highlighted the auto sector, and, in the past, many of your colleagues have called for the restriction of Japan's participation in the "domestic auto industry." AIAM believes it is time to bring the definition of the "domestic auto industry" into the Nineties.

Current commercial announcements, demonstrations and rallies would have Americans believe the U.S. automobile industry is composed just as it was in the 1950s -- its players being GM, Ford, and Chrysler, a handful of other struggling American manufacturers, and -- way out there -- a fringe of foreigners trying to capture a share of the "domestic" market.

But what may have been true forty years ago is no longer relevant. The automotive industry is international in scope, with participants from many countries engaged in all elements of the industry within the United States. New manufacturers have established design, development, and production facilities here. The three companies with world headquarters in the state of Michigan have expanded their production of vehicles in other countries, have established relationships with other international automotive companies, and have increased their own imports of vehicles into the United States. All manufacturers, regardless of the location of their world headquarters or principal development centers, have increased their use of parts sourced globally. As some would have Congress focus on developing more ways to distinguish "domestic" and "foreign" vehicles, the composition of vehicles from the design stage to final assembly is becoming more and more complicated and international. The patriotic "Buy American" theme may more aptly be called "Buy American nameplate." For example, which of the following two lists comprises American vehicles?

List 1	List 2
Buick Regal; Chevrolet Pickup; Chrysler Concorde and LeBaron; Dodge Caravan, Intrepid, Ramcharger and Stealth; Ford Crown Victoria, Escort, F-Series Trucks, Fiesta and Tempo; Geo Metro, Storm and Tracker; Jeep Wrangler; Mercury Capri, Grand Marquis and Tracer; Plymouth Colt; and Pontiac LeMans.	Honda Accord and Civic; Isuzu Rodeo; Mazda B-Series Truck, MX-6, Navajo and 626; Mitsubishi Eclipse and Mirage; Nissan Altima, Quest and Sentra; Subaru Legacy; Toyota Camry, Corolla and Pickup.

Answer: It is not clear. List 1 includes vehicles made by and for GM, Ford, and Chrysler outside of the United States and imported for sale in the United States. List 2 consists of vehicles made by other international manufacturers here in the United States by American workers.

The automotive industry in this country now includes many participants other than GM, Ford, and Chrysler: international companies who employ thousands of American workers, who invest billions of dollars in this nation's economy, and who are responsible for the dramatic increases in quality and variety American consumers now have in automotive products. President Clinton said it best during his speech at American University, "Products have clearly become more global. Now, if you buy an American car, it may be an American car built with some parts from Taiwan, designed by Germans, sold with British-made advertisements -- or a combination of others in a different mix." (February 26, 1993)

AIAM Contributions -- Jobs and Investments

The American auto industry is more than just GM, Ford, and Chrysler. Ever since the late-Seventies/early-Eighties, when Americans started turning to the more fuel-efficient Japanese cars, Japanese auto makers have been major players in the U.S. auto industry. In the Eighties, several of these companies began to signal their commitment to the U.S. market by moving production to the United States. Today, Honda, Isuzu, Mazda, Mitsubishi, Nissan, Toyota, and Subaru have manufacturing facilities in America, with BMW soon to follow. These new American plants represent over $10 billion of investment and directly employ about 40,000 Americans.

Many critics discount the value these new American manufacturing plants contribute to the U.S. economy. First, they assert just because they have "foreign" names, they can never be "American" or of value to the United States. This is short-sighted and not in our interest.

Secretary of Labor Robert Reich has stated on numerous occasions that foreign companies which employ Americans in factories in the United States are more worthy of government support than American-based companies with factories overseas. In fact, the Administration is wrestling with this issue which Ambassador Mickey Kantor has encapsulized, "Who are my clients -- American companies or American workers?"

AIAM believes its member companies play a significant part in the American auto industry, creating jobs and contributing to the U.S. economy. For instance:

- Collectively, the international car makers manufacture more cars in the United States than either Ford or Chrysler.

- In 1992, one in four automobiles manufactured in America was built by international automobile manufacturers.

- 400,000 American workers manufacture, import, distribute and sell vehicles in America made by the international automobile manufacturers.

- The international automobile manufacturers have invested over $10 billion in America. The Department of Commerce reported foreign direct investment in the motor vehicle sector was $3.7 billion in 1991 alone.

- The best selling American exported car to Japan is the Honda Accord from Marysville, Ohio. Toyota, Nissan, Mitsubishi, Isuzu, and Subaru are exporting cars built in their new American plants.

- In 1986, nearly all Toyota cars and trucks sold in the United States were manufactured in Japan. In 1991, some 45 percent of the Toyota brand cars sold in the United States were built in North America, including about 72 percent of the Corollas and Camrys. And facilities to build 100,000 light trucks in the U.S. were completed in the latter part of 1991.

- In Honda's case, over 50 percent of the cars it sells are made in the United States.

- R&D projects conducted by foreign-owned firms accounted for $350 million in 1990, based on estimates of the Department of Commerce's Bureau of Economic Analysis.

- Japanese auto makers are currently producing 1.4 million vehicles annually in the U.S., according to *Fortune* magazine. Annual production is expected to reach 2.5 million vehicles in the next few years. (November 16, 1992)

- According to a University of Kentucky study, for each person hired by the Georgetown, Kentucky Toyota plant, three additional jobs were created in the state.

AIAM Contributions -- Increased Quality and Competitiveness

Second, detractors contend the competition from these new American manufacturing plants has led to the troubles of GM, Ford, and Chrysler. Just the opposite. Again, President Clinton phrases it best, "The truth of our age is this, and must be this, open and competitive commerce will enrich us as a nation. It spurs us to innovate. It forces us to compete." (February 26, 1993)

The Japanese auto makers have improved American quality for more than a decade and have shared their manufacturing technologies with GM, Ford, and Chrysler. Cooperation and competition have led to the improvement in their competitive position. Protected from this competition, there is a great chance they would not have developed the innovations about which they now boast.

AIAM Contributions -- Increased Sourcing

Critics also allege that the new American manufacturers discriminate against American auto parts suppliers. This allegation seemingly stems from the fact auto parts imports increased with the start-up of the new American manufacturing plants. However, as these new plants have become more mature, they have increased their purchases from U.S. suppliers. For example, Toyota reports purchases of over $4 billion worth of U.S.-made parts a year. Of Toyota Motor Manufacturing USA's (TMM's) suppliers:

- 114 are U.S.-owned companies (a few Canadian);

- 29 are U.S./Japanese joint ventures;

- 7 are U.S./Japanese M&A (companies which were U.S.-owned when TMM formed supplier relationships and were later acquired by Japanese firms);

- 18 are Japanese traditional suppliers; and
- 6 are Toyota group companies (companies which are included in the consolidated financial statement of Toyota Motor Corporation/Japan). (1992 figures)

The new American manufacturers also have increased activities which will lead to heavier involvement by U.S. suppliers. For instance, Honda has expanded vehicle design, research and development, and production engineering in the United States. The Accord Station Wagon, introduced in 1991, was designed and tested in the United States. The original prototypes were fabricated here, as were the major dies. The car even was introduced in mass production exclusively at Honda's auto plant in Marysville, Ohio.

The bottom line to all this activity is that parts orders in the United States have increased. Honda reports that U.S. purchasing has risen to $2.9 billion, Nissan buys $2.35 billion in parts, and Mazda purchases are over $1.4 billion. According to the *Los Angeles Times,* total Japanese purchases of American-made auto parts in 1992 totaled $13 billion, a 44 percent increase over the last two years. (May 10, 1993)

Examining the U.S. auto parts industry more carefully, the difficulties facing this sector are primarily structural. According to the *Financial Times*, "The U.S. automotive parts industry is in the throes of a long and painful consolidation wave which is likely to eliminate many of the sector's weaker players but leave the strongest and most efficient companies significantly more profitable." (June 28, 1993) Parts companies' problems have been exacerbated by the recession which led to softer auto production and by Ford's, GM's, and Chrysler's moves to cut the number of their suppliers, concentrating on fewer, long-term relationships. In its survey of the industry, the *Financial Times* reports General Motors "has caused the biggest upheaval in the industry over the past year." (June 28, 1993) The newspaper recounts how GM, seeking to reduce costs, demanded price cuts of 20 percent or more from its suppliers in return for longer-term contracts. Another problem facing the industry, according to Michael Farren, the former Commerce undersecretary for International Trade, is that the higher quality of cars and parts is chilling the demand for replacement parts. While AIAM member companies increase their purchasing from U.S. suppliers, these structural problems will persist.

Reclassification

Finally, the Association would be remiss if it did not address an issue whose improper resolution could seriously threaten the livelihoods of many of your constituents -- that is reclassification of multi-purpose passenger vehicles (MPV) -- many people forget the *P* in *MPV* stands for *passenger*. AIAM believes reclassification would amount to seriously misguided policy. In fact, the United States Court of International Trade was asked if two-door Nissan Pathfinders were designed primarily for passenger or cargo use. In her ruling on this case, Judge Jane Restani found that "two-door sports utility vehicles...[are] motor vehicles primarily designed for the transport of persons." (Marubeni America Corp. v. The United States)

By reclassifying MPVs, the Government would increase the prices of these vehicles, both foreign and domestic, by $1,300 to $3,600, according to the Citizens for a Sound Economy. GM, Ford, and Chrysler will not stand idly by and not raise

their prices if MPVs are hit with a 25 percent duty as the result of reclassification. Take a look at what is going on as AIAM members are being forced to raise their prices due to the Yen's surge; mysteriously, the prices of GM, Ford, and Chrysler are creeping up as well. Thus, in reclassification, what the government would be doing is raising the price of these vehicles upon which so many families rely. MPVs take kids to soccer and dance practice, not concrete to a construction site. I do not think this Congress wants to raise taxes on the Middle Class -- which is what reclassification effectively amounts to.

In conclusion, today's auto industry is global, and U.S. policy should reflect this new dynamic. International auto manufacturers are a large part of the U.S. auto industry and make a significant contribution to this economy. Any government action that restricts access to the U.S. automotive market or places limits on investment opportunities for foreign-owned auto manufacturers would artificially and arbitrarily restrain competition. The effects of such restraints on competition are well known. Workers in the entire automobile industry would be at risk, and consumers would be faced with higher prices for products they desire -- if in fact such products remain available. To the 400,000 Americans whose families depend on the ability of international automakers to design, manufacture, distribute, sell, and finance motor vehicles in the United States, the freedom to compete is critical. To those responsible for setting government policy, this freedom -- which is the basis of a strong and competitive automotive industry -- fundamentally depends on the firm rejection of protectionism, in all its forms and guises.

Thank you for the opportunity to present AIAM's views.

JAMA

JAPAN AUTOMOBILE MANUFACTURERS ASSOCIATION, INC.

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WILLIAM C. DUNCAN, Ph.D.
GENERAL DIRECTOR

July 19, 1993

Ms. Janice Mays
Chief Counsel/Staff Director
House Ways and Means Committee
1102 Longworth House Office Building
Washington D.C. 20515-6348

Dear Ms. Mays:

As General Director of the Japan Automobile Manufacturers Association (JAMA), Washington Office, I am submitting the following comment and attachment for the record of the July 13 hearing before the Subcommittee on Trade of the House Ways and Means Committee on the subject of United States-Japan Trade, Commercial, and Economic Relations.

In the course of the hearing testimony, certain charges were made by the representative of the Automotive Parts and Accessories Association (APAA) regarding the Japan Automobile Manufacturers Association's efforts to assist U.S. suppliers in developing business with the JAMA member companies, who are the 13 producers of motor vehicles and motorcycles in Japan.

Specifically, the charge was made that an independent Boston Consulting Group Study, sponsored by the Japan Automobile Manufacturers Association, which addresses the real world issue concerning process technology capability was intended to serve as a forewarning "against celebrating additional sales gains too soon." Nothing is further from the truth. This is a total mis-representation of both substance and intent.

Significant progress has and is being made. In 1985 JAMA member companies purchased 1.7 billion dollars of U.S. sourced parts. JAMA members purchased 13.6 billion dollars during the 1992 fiscal year and despite a recent slump in vehicle sales, the individual members of JAMA are making substantial efforts to increase significantly the additional purchases of U.S. auto parts.

JAMA is playing an important facilitating and educational role in this process, which requires not only efforts on the part of JAMA member companies but also changes on the part of U.S. suppliers who seek to meet the high procurement standards required by the Japanese vehicle manufacturers of all their suppliers.

This material was disseminated by the Washington Office of JAMA which is registered with the Department of Justice, Washington, D.C. under the Foreign Agent Registration Act as an agent of the Japan Automobile Manufacturers Association, Inc. of Tokyo, Japan. This material is filed with the Department of Justice, where the required registration statement is available for public inspection. Registration does not indicate approval of the contents of this material by the United States Government.

These standards and practices, which are recognized world-wide for improving quality, increasing efficiency and lowering costs, are increasingly being adopted by other manufacturers as well in both the U.S. and Europe. Ask any US auto parts manufacturer who has been successful in selling to Japanese vehicle manufacturers and he will tell you that the relationship has made his company a better supplier to all of his customers. This is a known and often stated fact.

JAMA and its members have developed close working relationships with those U.S. auto parts manufacturers who are dedicated to expanding business and interested in developing specific programs to encourage this process. For example, Director level procurement executives of JAMA member companies meet twice a year with chief operating officers of U.S. supplier companies. This has led to a number of joint projects including a series of annual "One-on-One" conferences which bring together some 300 executives of over 80 U.S. parts manufacturers and some 200 executives of JAMA member companies to discuss business expansion opportunities on a company-to-company basis.

As part of this process, JAMA has issued publications or undertaken studies which are designed to lend transparency to the procurement system of the JAMA member companies. The latest of these publications, which was referred to in the hearing, was a report undertaken for JAMA by the Boston Consulting Group, entitled: "Context of U.S.-Japan Automotive Issues and Competitiveness of Automobile-parts Suppliers." This study seeks to identify those practices which characterize a successful relationship between manufacturer and supplier. Constant and close communication during the development and production process, for example, is one of the key aspects identified in the study. BCG calls this the "capabilities based" system. This report was intended to provide guidance to further a process of integration, not to impede that process as was suggested in testimony.

We submit the attached executive summary of the BCG study for the record of the July 13th hearing. This study was released at an auto parts seminar, held in Detroit on June 2nd and 3rd of this year. The seminar, entitled "Business Together: Selling U.S. Auto Parts to the Japanese Automotive Industry," was sponsored by the U.S. Department of Commerce in cooperation with Japan's Ministry of International Trade and Industry. JAMA and its Washington DC office played a key role in bringing top level executives from JAMA member companies to make presentations to some 300 supplier participants who attended the seminar. Representatives from the Japan Auto Parts Industry Association made presentations as well. The seminar was well received and JAMA and its Washington office were complimented by both the U.S. Department of Commerce and U.S. industry for the quality of the presentations and for assisting in facilitating the seminar.

It is surprising and indeed a bit discouraging to find that these efforts should be publicly castigated before one of the most honorable and influential policy-making bodies in the U.S. Government. At JAMA we have been focusing our efforts where it makes the most practical sense to do so and that is developing business opportunities between JAMA member companies and U.S. suppliers. We are committed to this process.

We would also call the Committee's attention to APAA's repeated reference to "JAMA's current 26% U.S. (ownership) sourcing figure." JAMA has never reported such a figure and to attribute it to this association is but another fabrication. To our knowledge, given the complex international relationships between and among auto and auto parts companies in today's global environment, data on purchases cannot effectively be collected on the basis of ownership.

Where this leaves the auto parts trade deficit with Japan, which relates to decisions made not only by JAMA member companies, but also by the big three U.S. vehicle manufacturers and some U.S. aftermarket parts suppliers as well, is a broader issue. However, it is interesting to note that the trends discussed above are beginning to be recognized even by groups who only two years ago were forecasting the trade deficit in auto parts to double to 22 billion dollars by 1994. More recent updates of this forecast put the deficit in the range of 8.8-10.6 billion dollars.

The extraordinary economic and structural changes that have and are taking place in the auto parts industry present challenges to all participants on both sides of the Pacific. JAMA for its part will continue to seek ways to play a significant role in addressing these challenges on the basis of fact. All we ask is that others do likewise.

We appreciate the Committee's attention and consideration.

Sincerely Yours,

William C. Duncan

William C. Duncan, Ph.D.
General Director

Attachments

Context of U.S.-Japan Automotive Issues and Competitiveness of Automobile-parts Suppliers

(Summary)

March 1993

The Boston Consulting Group

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• Overcoming Hurdles to Expanded Japanese Procurement of U.S. Auto Parts

The following is an overview of a competitiveness study of U.S. and Japanese automobile-parts suppliers. The study was conducted by the Tokyo office of The Boston Consulting Group from July to September 1992, following a request from the Japan Automobile Manufacturers Association (JAMA), and included interviews with 121 individuals at 56 automakers and parts suppliers in the U.S. and Japan.

Japanese automakers and U.S. parts suppliers have long enjoyed good relations and have undertaken a variety of efforts aimed at expanding opportunities for business with one another. The present study was undertaken to find ways of making these mutual efforts more effective.

We approached our competitiveness study by devoting much of our effort to understanding the reasons for the success and failure of individual business relationships between automakers and parts suppliers. Furthermore, given the limited amount of time for our study and the need to maximize our contribution to the ongoing automotive debate, we concentrated on establishing an objective framework in which further study can be carried out rather than coming to a conclusion based on existing quantitative data. In other words, we decided not to delve into such quantitative facets of competitiveness as cost, quality, and delivery, instead aiming to discover the reasons for the success and failure of many U.S. and Japanese parts suppliers whose cost, quality, and delivery were said not to differ very much.

As a result, we have reached the conclusion that there indeed exists a major "capabilities" difference between suppliers who succeed and those who do not. Detailed explanations with respect to various capabilities are provided in our report, and this overview will briefly summarize the consequences which a lack of these capabilities often leads to.

In our competitiveness study, we clarified the context of U.S.-Japan automotive issues from an objective viewpoint, described the common features of successful manufacturer-supplier relationships and termed this new development/manufacturing method the "capabilities-based system." We then assessed the competitiveness of U.S. and Japanese parts suppliers based on their ability to adapt to capabilities-based systems, thus paving the way for more accurate understanding of automotive debate and for its swift resolution.

Our findings can be summarized as follows. First we verified the fairness of the purchasing practices of Japanese transplants in the U.S. To support our conclusion that transplants did not unfairly discriminate against traditional suppliers, we classified the hurdles between parts suppliers and transplants into three broad categories, which are shown in Figure 1. We selected the three categories to separate the requirements based on suppliers' competitiveness from those based on unrelated factors. Among the three groups, the first involves what we have termed "accessibility hurdles." At this point, difficulties lie in securing enough time and proper presentation opportunities from automobile manufacturers' contact people. The second group of hurdles represents the initial trust-building and mutual-needs recognition process linking parts suppliers and automakers, necessary at the beginning of any new business relationship. Suppliers must thoroughly understand and prioritize the specifications and expectations of automakers while the automakers must understand the suppliers' ability to meet their needs. We have termed this second group of hurdles "initial entry hurdles."

These first two groups of hurdles are unrelated to parts suppliers' competitiveness, at least in the strict sense of the word. The third and last group of hurdles are those related to parts suppliers' ability to actually participate in and successfully contribute to automakers' "design-in" process. The suppliers must be on the automakers' list of "potential suppliers." These hurdles involve a parts supplier's ability to flexibly provide engineering know-how while absorbing the automakers' expertise during the development process, which includes design and prototype development. The greater this ability, the higher the probability that the parts supplier will eventually win contracts from the automakers. We have termed this group of hurdles the "competitiveness gap."

Accessibility hurdles have been substantially lowered in the last five years, partially as a result of U.S.-Japan trade talks (Figure 2). Of course, the geographical disadvantages of traditional suppliers still remain, and further efforts on the part of transplants to localize their R&D bases and expand their purchasing staff are needed.

Initial entry hurdles always exist regardless of national origin and industry; they are unrelated to competitiveness. Some companies make the choice not to overcome these hurdles because, given their particular business environments, satisfying the specifications of their potential customers does not make economic sense. Initial entry hurdles should be overcome through the efforts of individual suppliers. Industry organizations such as the JAMA and Motor and Equipment Manufacturers Association (MEMA) can extend a helping hand to struggling traditional suppliers by familiarizing them with past success stories and providing other sorts of assistance, such as guidelines, advice, and so forth.

Having thus delineated the kinds of hurdles parts suppliers face, we carefully examined the third type—the competitiveness gap these companies. The ability to overcome the competitiveness gap cannot be measured by such quantitative criteria as cost, quality, and delivery. The rationale is that there must be some other competitive factor determining the divergence in performance of various parts suppliers, since differences in these capabilities of most suppliers, U.S. and Japanese alike, are said to be rapidly disappearing. The most crucial conclusion of this report is that the success and failure of individual suppliers is based on their "capabilities" to interface their strengths and automakers' needs. Therefore the argument below summarizes this conclusion.

It is fair to say that the competitiveness of automobile-parts suppliers, as it is universally defined, should be measured by their contribution to automobile manufacturers' value chains. Suppliers have the greatest scope for contribution when they develop new parts for new or redesigned models. Particularly today, when automobiles have become mature products, their appeal largely determined by design and advanced technology, more and more creativity is being demanded in automobile parts. Therefore, the competitiveness of parts suppliers in terms of their creative contribution at the product development stage is significant.

In our study of U.S. and Japanese automobile-parts suppliers, we set out to determine the best method for developing technologically advanced industrial products, most notably automobiles, under time constraints. What we have termed the "capabilities-based system" is, simply put, a development process by which specialists synthesize their distinct capabilities and supplement each other's shortcomings under the guidance of a team leader. Its main aim is twofold. It seeks to extract and utilize the capabilities of each team member to the full. At the same time, it aims to add value by integrating the diverse capabilities of the team. In other words, a capabilities-based system aims to generate positive-sum results in the development of automobiles.

One of the conclusions of our study is that Japanese automakers and their parts suppliers have successfully adopted capabilities-based systems as their standard development method and that the development methods require a new set of capabilities on the part of components suppliers. The rest of this overview will elaborate on the prominent features of capabilities-based systems in detail.

In the development of a new automobile, a product development manager from the automaker corresponds to the team leader in a capabilities-based system. Supporting the development manager are various functional specialists who constitute the project team. It is important to note that these specialists come not only from the automaker but also from a variety of suppliers of parts ranging from electronics to brakes to the chassis.

The team leader need not create everything—quite the contrary. For example, a supplier of brake-related components is expected to propose ideas on how to further miniaturize current products; a supplier of electronic components ideas on how to improve the exterior appearance; and a supplier of chassis components ideas on how to contribute to assembly productivity during mass production. Of course, the team leader injects his or her own ideas into team discussions as well. The basic concepts of the new model are thus formulated by exploiting the team's capabilities to the full while maintaining total balance in the final output. The capabilities-based system differs from a simple division of labor in that the former requires parts suppliers to actively participate in the development process rather than simply receive orders from the automaker. Historically, the development and manufacture of industrial products have shifted from generalists to specialists. What we call the capabilities-based system takes this trend a step further.

Automobiles are designed and developed by integrating a wide variety of precision parts such as engines, transmissions, brake-related products, and electronic components. Therefore, capabilities-based systems are quite suitable for developing automobiles, especially today, when both creativity in individual components and the total balance of the final product are increasingly determining the success or failure of many models. Figure 3 shows the requirements of the capabilities-based system.

Our study has revealed that many traditional suppliers still have room for improvement in terms of their abilities to produce output on time throughout product development and to introduce appropriate know-how at the right time. Details with respect to traditional suppliers' ability to adapt to capabilities-based systems can be found in our report. During our three-month study, we encountered many instances in which traditional suppliers' inability to meet deadlines in product development had resulted in the delay or suspension of entire development schedules. Figure 4 cites a number of such instances.

For example, Supplier A failed to develop a burglar alarm on time. The supplier discovered a functional failure shortly before the scheduled delivery of the product. The failure was found in a customized integrated circuit out-sourced from an IC maker and was caused by an algorithmic error. Few Japanese automakers would blame only the IC maker for the delay in similar situations—most would likely place the blame at least partially on the parts supplier, who could have discovered and removed the algorithmic error at the design or prototype-development stages of the customized IC. In fact, it is assumed to be automobile-parts suppliers' responsibility to work with second- or third-tier suppliers to ensure prompt and high-quality output. In the case above, therefore, many Japanese automakers would blame the Supplier A for lack of guidance and supervision, rather than the IC maker that made the error. The parts supplier failed to guarantee sub-parts assembly.

Problems similar to those described in Figure 4 have seldom been experienced by Japanese parts suppliers in the past. The fact that we have encountered so many cases of friction in supplier relationships involving U.S. traditional suppliers has led us to conclude that there exists a considerable gap between many U.S. and Japanese parts suppliers in terms of their ability to guarantee prompt delivery of their products throughout product development.

Strictly speaking, adapting to capabilities-based systems should be the task of individual traditional suppliers. However, considering the political urgency of reducing the trade imbalance in automobile parts and the fact that only a handful of traditional suppliers have thus far managed to fully take advantage of capabilities-based systems, it may be advisable for various industry organizations and transplants themselves to assist U.S. traditional suppliers in adapting to the new development and manufacturing paradigm in the automotive industry. The first step may be to establish common recognition and understanding of obstacles facing many traditional suppliers in an objective framework.

In terms of capabilities, many of the U.S. automobile-parts suppliers surveyed in our study still have room for improvement. However, a number of U.S. companies have realized the importance of capabilities, and several success stories already exist. At the moment, transforming themselves into capabilities-driven enterprises seems like one of the surest ways for U.S. traditional suppliers to open doors to new business opportunities.

It is worth repeating that one of the most desirable solutions to U.S.-Japan automotive problems is to raise the competitiveness of local parts suppliers and encourage them to outsource locally from second- and third-tier suppliers. All local suppliers able and willing to contribute to the resolution of a major U.S.-Japan concern should be welcome regardless of their national origin. At the same time, protecting U.S. traditional suppliers without raising their competitiveness will only worsen the already problematic situation.

As stated at the beginning of this summary, a large portion of our study has been devoted to grasping the emerging development and manufacturing paradigm in the automotive industry. To formulate a comprehensive public policy with respect to the U.S.-Japan automotive trade imbalance based on the framework established in our report, further study is needed, especially if the policy is to convince automotive producers as well as hundreds of millions of consumers in the two countries.

Figure 1 Hurdles Facing Traditional Suppliers Before Entering Business Relationships with Transplants

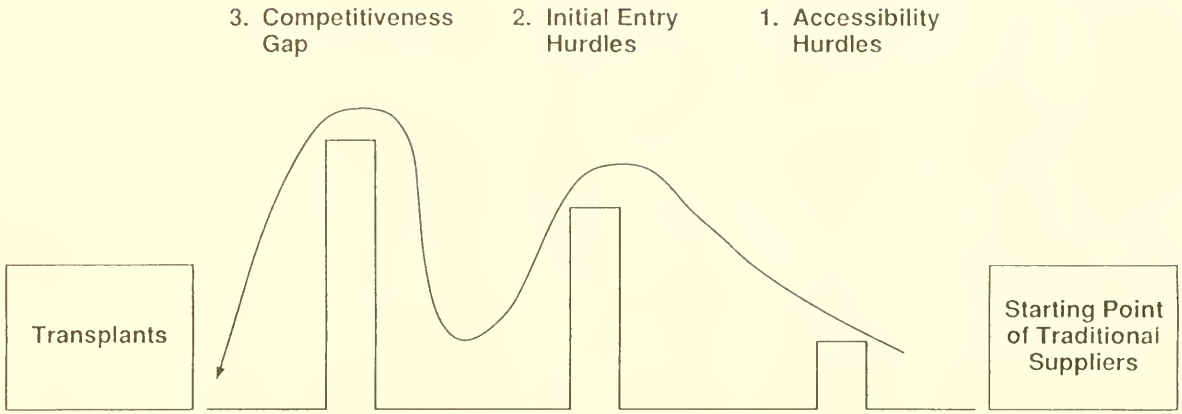
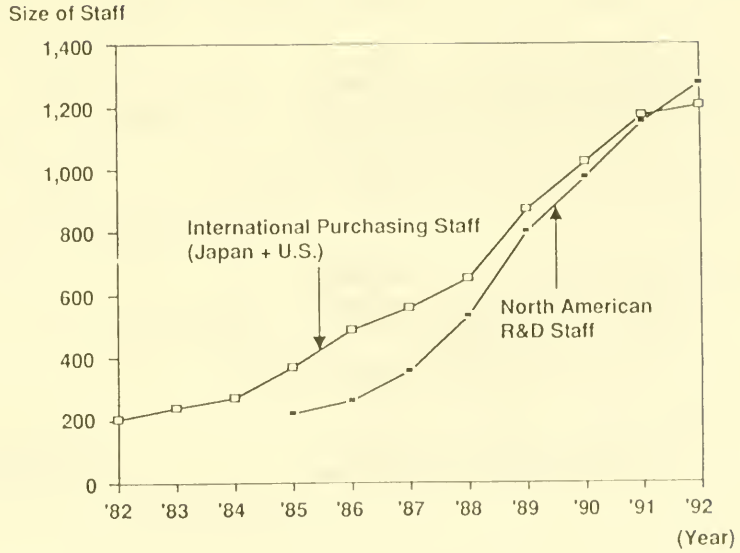


Figure 2 Purchasing Staff at Japanese Automakers
(1982–1992, Size of Staff at Top Five Automakers)



Sources: Auto Makers; BCG Analysis

Figure 3 Progress Required to Adapt to Capabilities-Based System

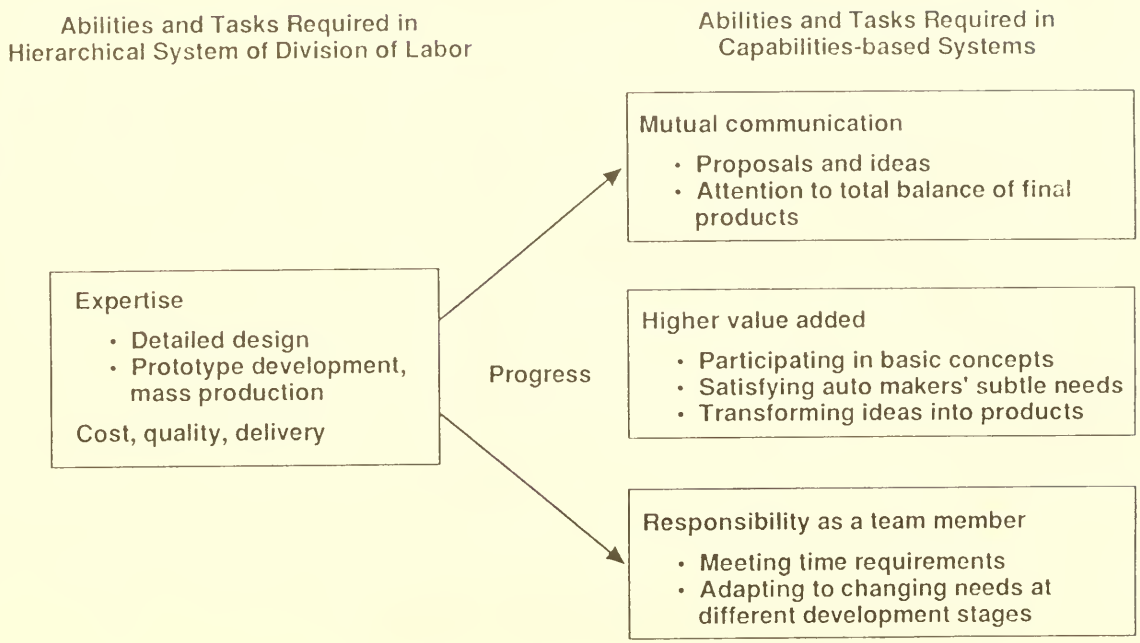


Figure 4 Examples of Delayed Delivery of Outputs and Suspension of Product Development

Company	1985 1986 1987 1988 1989 1990 1991 1992	Component	Problems
Supplier A (Top traditional supplier)	Planned: 1988 – 1990 Actual: 1988 – Discovery of problems – Delayed into 1993	Burglar alarm	• Problems in customized IC - failure to detect early problems (design error of sub-components supplier)
Supplier B (Top traditional supplier)	Planned: 1986 – 1988 Actual: 1986 – Suspension of product development	High-tension cord	• Failure to produce prototype - unable to clear the patent held by a Japanese supplier
Supplier C (Top traditional supplier)	Planned: 1986 – 1988 Actual: 1986 – Mass production test	Oil filter	• Failure to pass prototype test • Failure to submit improved prototype on time(unable to submit improved prototype before the test run and finally did so a year later)
Supplier D (Top traditional supplier)	• First delivery of prototype: 4.5 months late • Second delivery of prototype: 6 months late → Declined to continue submitting prototype	High-tension cord	• Unable to produce prototype which satisfied given specifications

Source: BCG Interviews

NATIONAL FOREIGN TRADE COUNCIL, INC.

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July 20, 1993

The Honorable Sam M. Gibbons
Chairman
Subcommittee on Trade
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Chairman Gibbons:

The National Foreign Trade Council, Inc. (NFTC) appreciates the opportunity to submit comments on initiatives to improve the economic relationship between the U.S. and Japan and to reduce existing tensions between the two countries on economic matters of importance to the NFTC membership.

The NFTC is a trade organization with some 500 members, founded in 1914. Its membership consists primarily of U.S. corporations engaged in all aspects of international business, trade, and investment. The NFTC's emphasis is to encourage policies that will expand U.S. exports and enhance the competitiveness of U.S. companies by eliminating major tax and trade inequities in the treatment of U.S. companies conducting business abroad.

The NFTC would recommend that the U.S. adopt the following initiatives as a means of removing structural impediments that either deny U.S. companies access to Japanese markets or prevent U.S. companies from competing for a larger share of the Japanese market.

Proposal. The NFTC urges the U.S. to pursue a renegotiation of the existing income tax treaty between the U.S. and Japan to reduce the withholding rates from 10 to 5 percent,respectively, on royalty payments and on most intercorporate dividend distributions.

Rationale for the Proposal. The following reasons support a reduction of the withholding rates on dividends and royalty payments as part of a renegotiation of the existing U.S./Japan Income Tax Treaty.

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1. Reduction of Withholding Rates on Royalty Payments and Intercorporate Dividends will Allow U.S. Companies More Effectively to Compete with Japanese Companies in their own Markets. The NFTC strongly believes that a reduction in withholding rates from 10 to 5 percent on royalty payments and on most intercorporate dividend distributions will allow U.S. companies more effectively to compete with their Japanese counterparts in the Japanese marketplace. Since Japanese companies do not feel the impact of the 10 percent withholding rate on dividends and royalty payments, they are able to attract capital more efficiently than U.S. companies and can underprice their products in Japan relative to U.S. companies.

NFTC member companies are in complete agreement that a key element of Japanese business success in the global economy is their ability to dominate Japanese markets. By maximizing profits in the Japanese economy, Japanese companies can subsidize both their expansion in the U.S. market and their penetration of new markets abroad. A reduction of the withholding rates on royalty payments and on most intercorporate dividend distributions would ameliorate a structural impediment to the expansion of U.S. business activity in Japan.

2. Reduction of Withholding Rates on Royalty Payments and Dividend Distributions Would Move the U.S./Japanese Income Tax Treaty Closer to U.S. Policy as Reflected in the U.S. Model Income Tax Treaty. The U.S./Japan Income Tax Treaty provides for withholding rates on royalty payments and intercorporate dividend distributions of 10 percent. The recently withdrawn U.S. Model Income Tax Treaty provides for an exemption from withholding on royalty payments and a maximum rate of 5 percent on most intercorporate dividend distributions. (See Article 12 (1)/Royalties; Article 10 (2)(a)/Dividends). While the U.S. Model Income Tax Treaty just alluded to is no longer in effect, there is no reason to believe that a newly issued Model Income Tax Treaty will increase the withholding rates on either royalty payments or intercorporate dividend distributions.

Historically, U.S. tax treaty policy has favored residence based taxation, which means either an exemption from withholding or lower withholding rates depending on the category of income involved. The rationale for residence based taxation is to reduce or eliminate double taxation and to promote the free flow of capital between treaty partners by eliminating tax barriers. Reduction of the withholding rates on royalty payments and on intercorporate dividend distribution clearly would reduce the incidence of double taxation on income earned by U.S. companies in Japan and would promote their competitiveness in Japanese markets.

3. Reduction of Withholding Rates on Royalty Payments and on Most Intercorporate Dividend Distributions Would Encourage Direct Japanese Investment in the U.S. A reduction of the withholding rates from 10 to 5 percent on royalty payments and on most intercorporate dividend distributions would promote increased direct investment by Japanese companies in the U.S. This development would lead to greater capital investment and increased employment for the U.S. economy. Moreover, it is quite probable that U.S. revenues derived from withholding tax collections would increase on royalty payments and dividend distributions from Japanese subsidiaries in the U.S., due to the incentive of lower withholding rates.

For the foregoing reasons, the NFTC urges the renegotiation of the existing U.S./Japan Income Tax Treaty to reduce withholding rates from 10 to 5 percent on royalty payments and on most intercorporate dividend distributions.

The NFTC appreciates the opportunity to submit comments on tax and trade initiatives that could improve the economic ties between Japan and the U.S. We would be delighted to answer any questions that you might have.

Very truly yours,

Robert H. Green

Robert H. Green
Vice President/Tax Policy

STATEMENT OF
NISSAN NORTH AMERICA, INC.

TO THE
SUBCOMMITTEE ON TRADE
COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

U.S.-JAPAN ECONOMIC RELATIONS

JULY 19, 1993

INTRODUCTION

Nissan North America, Inc. is a wholly-owned subsidiary of Nissan Motor Company, Ltd. of Japan, the world's 5th largest producer of motor vehicles. We submit this statement for the hearing record for ourselves and on behalf of three other Nissan companies (hereafter "Nissan") doing business in the United States: Nissan Motor Manufacturing Corporation U.S.A., Nissan Motor Corporation in U.S.A., and Nissan Research and Development, Inc.

Nissan Motor Manufacturing Corporation U.S.A. (NMMC), located in Smyrna, Tennessee, builds Nissan passenger cars and pick-up trucks for customers in the United States and Canada. NMMC celebrated its 10th anniversary of "JOB 1" — the first vehicle the company made to be offered for sale — last month. The company makes three models: the Altima mid-size family sedan, the compact Sentra, and the Nissan pick-up truck. NMMC also supplies stampings and engines to Ford Motor Company for the Nissan-designed compact family van that Ford assembles in Ohio and that both Nissan (as the Nissan Quest) and Ford (as the Mercury Villager) sell. NMMC's production capacity stands at 450,000 units and the company employs nearly 6,000 people. Capital investment in NMMC's Tennessee manufacturing operations now stands at $1.35 billion.

Nissan Motor Corporation in U.S.A. (NMC), located in Carson, California, is the distributor in the continental United States of new Nissan motor vehicles built in the United States as well as in Japan. NMC currently employs some 2,290 people. The approximately 1,200 dealers who sell Nissan vehicles, 60 percent of which are now built in the United States, employ over 50,000 more.

Nissan Research and Development, Inc. (NRD), located in Farmington Hills, Michigan, is Nissan's American engineering arm. NRD operates an $80 million technical center whose mission is to design Nissan vehicles for the American market and to work with American suppliers of automotive parts and components to bring them into Nissan's product development system. NRD currently employs approximately 450 workers nationwide.

This profile is clear evidence that Nissan is committed to making itself into a fully integrated U.S. motor vehicle manufacturer and that we are well on our way to achieving that objective. Through our closely integrated design, R&D, manufacturing, importing, marketing, and sales operations, Nissan is making a significant contribution to the U.S. economy that will continue to grow over time as Nissan's American roots grow deeper and wider.

U.S.-JAPAN TRADE RELATIONS AND NISSAN

The Subcommittee's hearing notice invited comment upon four factors it identified as sources of friction in the U.S.-Japan trade relationship: Japan's large merchandise trade surplus with the United States; barriers to market access in Japan; Japanese imports into the United States in key sectors; and allegations that Japanese-owned companies in the United States engage in anti-competitive practices. The automotive sector has been cited in the media and elsewhere as an element in each of these issues. The imbalance in bilateral trade in autos and auto parts accounts for a large portion of Japan's trade surplus with the United States. The Subcommittee's hearing notice itself identifies Japanese auto imports as a "problem" and further identifies "sectoral barriers" in Japan's auto and auto parts sectors as a source of difficulty. Finally, the purchasing practices of Japanese-owned automotive manufacturers in the United States are alleged to be unfair.

Nissan has an obvious stake in each of these issues. We are an American manufacturer, importer, and distributor of Nissan motor vehicles, and a wholly-owned subsidiary of a Japanese parent company. We do not hold ourselves out as experts either on international finance or the Japanese market. We do, however, have insights to offer the Subcommittee on each of the issues it has identified and we appreciate the opportunity to present them. Before addressing those issues, however, we want to place them in the context of competition in the automotive industry and its role in U.S.-Japan economic relations.

Nissan, and the other "new entrant" automotive manufacturers in the United States are at the very center of the dynamics of the "global economy" about which Americans read, and talk — and worry — so much. The basic story of the U.S. automotive industry over the past 15 years is familiar to the Subcommittee. Imports soared from the late 1970s and the Detroit automakers lost sales, market share, production, and employment because they were not up to the standards of global competition. To survive, the industry was forced to restructure. One element of that restructuring was the remaking of the Detroit automakers, a long, costly, and painful process. The other equally important element was the entry of new competitors into the market, companies like Nissan.

That restructuring is now bearing fruit. The Detroit automakers have taken enormous strides to improve productivity and quality and are regaining market share. The new entrant producers are maturing into fully integrated U.S. producers and have become an integral part of the U.S. industry. It is no exaggeration to say that a new automotive industry now exists in the United States, one that is much stronger, much more competitive than the industry that existed just a decade ago.

The Detroit automakers point to Nissan and other Japanese companies for the pain of the restructuring they endured. Not surprisingly, perhaps, we see things differently. The Detroit automakers and some of their suppliers created their own competitiveness problems and must accept responsibility for the pain that adjusting to the demands of global competition caused. While from the perspective of the Detroit automakers, we may have seemed to be the problem; from the perspective of creating a competitive automotive industry in the United States, we have been and continue to be an important part of the solution.

We were the agents of change, the catalysts for the creation of a competitive automotive industry in the United States — both by virtue of the competitive products we initially imported and now increasingly build here, and through the broader impact of our investments in design, engineering, and manufacturing in the United States. We helped to transform the "U.S. automotive industry" into what is now a world class "automotive industry in the United States."

The impact of the investments by Nissan and other new entrant manufacturers is usually measured in terms of the amount of capital invested (now $9.6 billion in manufacturing facilities alone, $1.35 billion of it by Nissan), the number of jobs created (35,000 employed in building vehicles in the seven new entrant and joint venture companies now located in the U.S.), the direct and indirect payroll contributions to local economies, "ripple effects" through supplier purchases, charitable contributions made, and similar indicators. While debate flourishes about the magnitude of the net positive impact of the new entrants, there is no doubt in the minds of independent analysts that the impact is positive. These contributions are significant but they are not the whole story. They fail to take into account the key role played by the new entrants in the revitalization of the Detroit automakers.

We introduced the Detroit automakers to new management techniques, new relationships between management and labor, and new ways of organizing work. By giving workers more responsibility and more training, by equipping them with more skills, and by empowering them to exercise greater control over the work they do, we showed the way to building a work force that is more productive, more competitive, more satisfied, and more secure.

We introduced the traditional U.S. industry to new relationships between manufacturers and suppliers. By giving suppliers more responsibility for the work that they do and by showing them how to work more productively, we helped to improve and accelerate the product development cycle in the U.S. automotive industry, making it more efficient and enabling it to produce higher quality products. And, of course, we introduced new technologies.

We claim no monopoly on wisdom. Just as we adapted and improved upon the innovations and techniques we learned from our parent company, the Detroit automakers and some suppliers have adapted and improved upon our innovations. We are now all learning from each other through joint production arrangements like the Nissan/Ford Quest/Villager compact family van and joint ventures like New United Motor Manufacturing, Inc. (NUMMI). We have been — and we will continue to be — an important catalyst for change in the U.S. automotive industry and beyond. U.S. industry is stronger and better able to compete in a challenging global environment because of us.

SOURCES OF FRICTION IN U.S.—JAPAN ECONOMIC RELATIONS

Administration officials, in describing the intellectual underpinnings of their emerging trade policy *vis-à-vis* Japan, explain that Japan presents the United States, and the world, with two related problems: an "imbalance problem" and a "penetration problem." By "imbalance problem" the Administration says it means Japan's large and growing global external surplus. By "penetration problem" it means the low — relative to other countries — participation of foreign manufactured goods and investment in Japan's economy, i.e., market access. Although we disagree with some of the conclusions the Administration has reached with respect to how best to address these problems, we will use the Administration's starting point to guide the discussion that follows.

We make two fundamental points in this statement. First, it is important to understand correctly the nature of the "imbalance problem" in order to reach appropriate conclusions both as to what should be done about it as well as what should not be done. Second, it would be incorrect to confuse a trade imbalance in a particular industry sector with that "imbalance problem" and incorrect to presume a particular sector imbalance is evidence of a market access problem, or of anti-competitive behavior. A bad diagnosis will lead to destructive policies — protectionism in the form of quotas, market share limits, domestic content requirements, or mandated purchasing targets. A perfect example is the call to eliminate the automotive trade imbalance between the United

States and Japan, a transparent ploy for government intervention to limit competition in the automotive industry here in the U.S.

THE "IMBALANCE PROBLEM"

Japan's growing trade surplus with the United States — $49 billion last year — may be a political lightning rod but it is not the "imbalance problem" upon which U.S. policy should focus. To the extent that the trade imbalance with Japan reflects legitimate U.S. market access complaints, action by Japan to resolve those complaints is warranted. Action is warranted because the U.S. and Japan should have fully equivalent opportunities to participate in each other's markets, not because there is an imbalance in our bilateral trade. Neither the imbalance nor its recent growth can be attributed to market access impediments.

After falling 26% between 1987 and 1990 (from $56 billion to $41 billion), Japan's trade surplus with the United States has now grown to more than $49 billion. However, no responsible analyst credits this expansion of Japan's trade surplus to trade barriers. The culprit is Japan's recession.

U.S. exports to Japan grew by more than 100% — from $23 billion to $49 billion — between 1985 and 1990, but were flattened by Japan's recession. Meanwhile, Japan's exports to the United States continued to grow after 1990, a modest 8%, as the U.S. economy grew anemically. Thus the growth in Japan's surplus reflects the relative strength of our economy, not just its weaknesses.

Of course it has been argued that even at its recent "low water mark" of $41 billion, Japan's trade surplus with the United States is "intolerable." Indeed, legislation has been introduced in Congress in recent years declaring any Japanese trade surplus with the United States unacceptable and mandating the virtual elimination of the trade imbalance. As appealing as this simplistic call may be for some, it is nonetheless true that there is no justifiable economic rationale for adopting trade policies aimed at eliminating a bilateral imbalance. (That is a good thing, of course, since the U.S. runs trade surpluses with the European Community and Mexico among others.)

There is, in fact, sound logic for concluding that an imbalance of trade of some magnitude between the United States and Japan is inevitable and not undesirable, so long as we bring our overall global external position into reasonable balance. The logic behind this conclusion — based on the nature and composition of Japan's trade with the United States — was persuasively presented to the Subcommittee in the recent testimony of Fred Bergsten of the Institute for International Economics.

The real "imbalance problem" that both U.S. and Japanese policy should aim to address is the excessive magnitude of the imbalance between Japan's unprecedented global, current account surplus and the United States' persistent global, current account deficit. These imbalances reflect, and indeed are determined by, mirror-image imbalances in domestic savings and investment patterns in the United States and Japan. It is these domestic imbalances that must be rectified in order to reduce our external imbalances. U.S. fiscal deficit reduction and higher rates of Japanese growth, combined with the exchange rate adjustments that have already occurred, are the way to fix the "imbalance problem."

A country's external financial position is determined by fundamental internal factors. Thus, attempts to manipulate trade balances are bound to fail. If, for example, the United States adopted protectionist policies to restrict imports of certain products, or the United States forced Japan to expand imports of certain goods, and there were no changes in the basic domestic factors underlying the imbalance, then our two economies would compensate for these trade policy distortions. In the case of the U.S. example, we

might import greater volumes of other, non-restricted goods. In the case of the Japan example, it might also import fewer non-designated goods. The composition of our imbalance may change — benefiting some companies and workers at the expense of others — but the basic imbalance could persist. The imbalance could be artificially reduced but only by the adoption of radical protectionist measures that would impose huge costs in terms of reducing welfare in both countries.

The Imbalance in Automotive Trade and Market Access

If a bilateral trade imbalance is not an appropriate justification for trade policy action, then the existence of a sectoral bilateral imbalance provides even less justification. That, of course, is a good thing since the United States enjoys sectoral trade surpluses with most countries in such products as commercial aircraft, industrial machinery, scientific instruments, chemicals, and pharmaceuticals among others.

Trade in automotive products comprises a substantial portion of the overall imbalance in trade between the United States and Japan. The sectoral imbalance has been relatively stable in recent years, about $31 billion. Presently, it accounts for more than 60% of the overall bilateral imbalance. That fact is incontestable. Equally incontestable, we contend, is the fact that market access impediments have nothing to do with this imbalance.

Trade in Vehicles: The Imbalance Problem. In 1992, Japan exported to the United States $22.3 billion worth of cars, multipurpose passenger vehicles (MPVs), and trucks. In 1992, the United States exported to Japan $890 million worth of cars, MPVs, and trucks. This disparity in vehicle trade is cited by some as "evidence" of a closed Japanese market. That conclusion of causal relationship lacks a foundation in facts.

The disparity is explained by two factors: (a) the relative strength of the U.S. and Japanese auto industries, and (b) the level of commitment and effort U.S. and Japanese auto companies have made to compete in each other's markets. The disparity reflects an imbalance in competitiveness and commitment, not an imbalance in market access.

American consumers "discovered" Japanese vehicles when they turned to them for their superior fuel economy during the "oil shock" of the late 1970s. What consumers "discovered" was not only the superior fuel efficiency of Japanese vehicles but also their superior quality and durability. To exploit this competitive advantage, Japanese companies made large investments to develop distribution and service capabilities, to discern the special needs and tastes of American consumers and to modify their vehicle designs to fulfill those needs and tastes, and to build their vehicles to comply with the very different regulatory requirements of the U.S. Government.

These market-driven actions resulted in a soaring demand for Japanese vehicles and Japanese exports to the United States in the early '80s until they were capped by trade restraints. The pressure of trade restraints combined with sound business logic led Japanese companies to make huge investments in U.S. manufacturing facilities. The effect has been a dramatic decline in the number of Japanese vehicles exported to the United States — Japan exported 1.66 million fewer vehicles in 1992 than in 1986 — and a corresponding increase in the number of Japanese-nameplate vehicles built in the United States — from nothing a little more than a decade ago to 1.7 million in 1992. The value of Japan's exports to the United States also fell but not in tandem with the decline in the volume of export shipments because of a higher-value mix of vehicles exported from Japan and the yen's appreciation.

Trade in Vehicles: The Access Issue. The history just described explains one side of the imbalance equation. But what about the other side of that equation, exports of vehicles from the United States to Japan? Why are they so low?

Market access impediments did play a role at one time. Japan's market was once closed to imports and foreign investment as Japan pursued a policy of temporary "infant industry" protection while it rebuilt its economy after World War II. But that was a long time ago. Border measures were lowered during the 1960s and completely eliminated in the 1970s. Since then, however, U.S. manufacturers have alleged that non-tariff barriers — standards/certification procedures and distribution — inhibit their access to Japan's market.

Japan's standards and certification procedures are no more burdensome for foreign than for domestic manufacturers. In fact, preferential procedures have been established for small volume importers with the result that the regulatory "burden" the Detroit automakers face in Japan is considerably less than the burden Japanese manufacturers face in either Japan or the United States. Complying with legitimate foreign governments standards is an obligation incumbent upon any company engaging in foreign trade. So long as the Detroit automakers build their vehicles to U.S. standards and then modify them afterward for sale in Japan, they will experience a self-imposed disadvantage. This is a "chicken-egg" business problem, not a market access impediment.

As for distribution, while people tend to forget that Japanese manufacturers were anything but enthusiastically embraced by U.S. dealers when they arrived in the United States in the 1950s and 1960s, it is true that Americans today face a more difficult situation today than Japanese companies faced in the United States 30 years ago. For one thing, the cost of establishing distribution and sales networks in Japan today is high; indeed, the cost of everything in Japan today is high after converting dollars into yen. (This is one downside of the Administration's strategy of driving up the value of the yen: it lowers the cost of U.S. exports in yen, but it also makes the cost of doing business in Japan for American companies wanting to expand sales much higher.) Moreover, career mobility in Japan, though rising, is still limited compared to the United States so recruiting experienced personnel is a challenge. In economic terms, these are "barriers to entry" but they are not "trade barriers."

Even taking at face value — which we do not — the market access complaints of the Detroit automakers, they still cannot explain the low level of Detroit automakers' sales in Japan. Germany and Britain both export more vehicles to Japan than do the Detroit automakers. France and Sweden export nearly as many. As it has become fashionable to make third country comparisons to reach judgments about the relative openness of markets, it is worth noting that the market share of European automotive manufacturers in the United States and in Japan is virtually identical. If the U.S. market is "open," what does that say about the Japanese market?

The fact is that the Detroit automakers have not made a serious effort to enter the Japanese market. There is some evidence that this situation may be changing. It remains to be seen whether this newfound interest in the Japanese market will remain serious and consistent over the long term.

Fewer than 1% of the models the Detroit automakers sell in Japan are powered by engines of 2,000 cc or less. That means the Detroit automakers are competing for just 14% of the Japanese market because 86% of the cars sold in Japan are equipped with engines of 2,000 cc or less. Even worse, 84% of U.S. auto exports to Japan are equipped with engines of 3,000 cc or more. That market segment accounts for just 3% of Japanese sales.

Even now, only one Detroit automaker's model made in the U.S. with its steering column on the right hand side is currently sold in Japan. There is some demand for left-hand drive in Japan (and some European manufacturers offer both left- and right-hand

drive) but that is a novelty market, accounting for an extremely small share of Japanese demand.

Only 10% of the Japanese market is accounted for by sales of vehicles that cost more than 3 million yen. Ninety percent of Detroit automakers vehicles are priced over 3 million yen.

Given the relative competitive strengths of Japan's manufacturers and negative public perceptions in Japan about the quality of Detroit automakers products (fed by negative perceptions in the United States and the Detroit automakers' demands for protection from Japanese competition), the Detroit automakers have appeared content to participate in the market through their equity investments in Japanese companies. With their dramatically improved levels of quality and their potentially stronger price competitiveness as a result of the yen's appreciation, the prospects for the Detroit automakers in Japan have brightened. To succeed, however, they have much to do. Surmounting trade barriers is one thing they need not worry about.

Even AUTOMOTIVE NEWS, the U.S. industry's weekly "bible," recently editorialized that:

> ... the notion that the Japanese should open their market to Detroit automakers cars is really a non-issue. The Detroit automakers haven't done the necessary spadework. And technically, the Japanese market is open now ...

In their new book that drew considerable attention at the Subcommittee's hearing — *RECONCILABLE DIFFERENCES?* — authors C. Fred Bergsten and Marcus Noland write that:

> Questions remain, however, as to the seriousness of the Detroit automakers' commitment to selling finished cars in the Japanese market. ... Indeed, some have argued that the Detroit automakers have no real interest in penetrating the Japanese market — that the actual goal of these complaints is to justify protectionism at home.

Until the Detroit automakers make a serious and sustained commitment to export to Japan — by catering to Japanese consumers' distinct preferences in the design of their vehicles, by building vehicles to meet Japanese standards rather than modifying them car by car, and by doing more than just talking about the challenges of distribution — this suspicion will be a compelling one.

Trade in Automotive Parts. Government officials and industry experts in both the United States and Japan concur that there are significant problems with the statistics measuring trade in auto parts because many parts are classified in other product categories. There is no doubt about the basic trends and orders of magnitude, however. As Japanese manufacturers have invested in production facilities in the United States and as the fleet of Japanese vehicles (both U.S.-built and imported) has expanded and aged, exports of Japanese auto parts — both "original equipment" and "aftermarket" — to the United States have grown. They rose more than 300% from 1985 to 1989 and have since leveled off at between $10 billion and $11 billion annually. U.S. auto parts exports to Japan have grown even more rapidly but started from a much smaller base; by the understated official statistics they just exceed $1 billion. This has produced an official trade imbalance in auto parts of about $10 billion over the past several years.

It has been alleged that the low level of U.S. auto parts exports to Japan, the high level of Japanese auto parts exports to the United States, and the sales of Japanese-owned auto parts companies in the United States to new entrant manufacturers are evidence of "market access" impediments, namely an unwillingness on the part of Japanese and Japanese-owned American companies to do business with non-Japanese firms. As a U.S. Treasury official explained to a Japanese audience recently: "We are focusing on sectors,

like automobile parts, where market forces do not hold sway because of close connections between ... firms and suppliers..." While the trade statistics and procurement data are undeniable, the conclusion drawn from them — of "market access" impediments or anticompetitive practices — is nevertheless wrong. The purchasing practices of Japanese automotive companies are strongly market driven and they have been highly pro-competitive, not anticompetitive.

Analysts and observers of the U.S. auto industry during the 1980s were quick to acknowledge the severe competitiveness problems of the Detroit automakers. They were not so quick to understand that the Detroit automakers' relationships with and capabilities of U.S. parts suppliers were also part, a substantial part, of the problem.

When Nissan first began manufacturing operations in the United States, there were few U.S. suppliers that could satisfy our quality, price, and delivery purchasing criteria, even for relatively unsophisticated generic parts. Because, with few exceptions, U.S. suppliers lacked product development skills — they relied upon the Detroit automakers to provide them with complete component designs — they were also unable to participate in Nissan's product development system for sophisticated parts. Supplier firms in the U.S. and Japanese automotive industries traditionally have played very different roles; much more is expected of suppliers in the Japanese production system. As a result, few U.S. firms were able to meet our fourth purchasing criteria, product development capabilities.

Like the U.S. vehicle industry, the U.S. supplier industry has taken impressive strides in recent years. Once again, two factors have been at work in the industry's restructuring: (1) "traditional" U.S. suppliers remaking themselves, and (2) the entry of new competitors through foreign investment. Foreign-owned supplier firms have now become an integral part of the U.S. supplier industry. "Traditional" U.S. firms, while still not the match of the best Japanese supplier companies, have reduced their defect ratios and sped up their delivery capabilities. Their price competitiveness *vis-à-vis* imports has also strengthened with the appreciation of the yen. And a growing number have developed stronger product development capabilities. A recent research study prepared by the Boston Consulting Group concluded that:

> ...[W]hile it is true that traditional suppliers' competitiveness in mass production has dramatically imporved in recent years, they still lag behind their Japanese counterparts both in the U.s. and in Japan in terms of their ability to adapt to deliver their output on time at each stage of product development. Many of them also lacked the ability to contribute engineering know-how and innovative concepts.

As for Nissan, we have dramatically expanded our ability to work with U.S. suppliers — through our creation of Nissan R&D in the United States, by NMMC's launching a supplier-support program to advise supplier firms on how to improve their production processes, and by our parent company's expanding its capabilities to work with American suppliers at its Technical Center in Japan. Similar developments are taking place across the industry.

Far from being anticompetitive, the effects of Japanese companies' purchasing practices have been strongly pro-competitive. The demanding quality standards of Japanese and Japanese-owned American firms have forced American suppliers to improve — not just to sell to the new entrants but also to keep the business of the Detroit automakers. And as the Detroit automakers and U.S. suppliers have embraced aspects of the Japanese automotive production system, both have benefited from the shorter product development cycles, stronger productivity, and improved quality that the system yields. Once again, restructuring has been difficult and painful, but it is producing a more competitive and healthier U.S. supplier industry.

The competitiveness and capability impediments to higher sales of U.S. auto parts to Japanese and Japanese-owned American firms are falling. As a result, sales are rising. Purchases by Japanese and Japanese-owned U.S. companies of U.S. auto parts have risen from under $2 billion in FY1985 to $13.6 billion in FY1992. The number of American firms doing business with Japanese and Japanese-owned American vehicle manufacturers in the same period has grown from fewer than 300 to more than 1,150. Even last year, when the automotive markets of both the United States and Japan were stagnant, sales of U.S. auto parts grew nearly 30%.

Just two years ago, the University of Michigan published a study that predicted the 1994 auto parts trade imbalance between the United States and Japan would reach $22 billion. According to press reports, the University will soon make a new prediction that next year's deficit will be less than half that amount and may shrink further. Things are moving in the right direction — in response to market forces.

Today's automotive marketplace is highly competitive. As anyone who has shopped for a car lately can attest, Japanese nameplates as a group are competing at a substantial price disadvantage. The notion that in this environment manufacturers can make purchasing decisions that ignore market forces and rely instead upon "traditional ties" between manufacturers and suppliers defies all common and business sense.

The dramatic appreciation of the yen this year coming on top of its appreciation since 1985, gives Nissan and other companies that import parts from Japan (the Detroit automakers as well as other new entrant firms) an additional incentive to "buy American" and we are all working hard to cut our costs. But we compete on the basis of value, however, and not just price. As a result, suppliers must continue to meet *all* of our stringent purchasing criteria. Those that do meet our criteria — regardless of who owns them — become Nissan suppliers.

CONCLUSION

Competition is hard: adjustment is often painful. The pain can motivate all those involved — companies, workers and governments — to seek relief, to alleviate the pressure, and to shift the costs to consumers (and, along with the blame, to foreigners). Such efforts to run nd hide from global competitive pressures spawned the voluntary export restraint agreements (VERs) of the 1980s and proposals for 'voluntary' import expansions (VIEs) in the 1990s. Yet such futile escapism fails even to begin to address the underlying problem, the inability to compete. Worse, by providing a shield against competition, it delays the adjustment that is required to become competitive.

As the President has said, "we must compete, not retreat." We must find a way to make change our "friend" rather than our "enemy." Competition is ultimately a friend that enriches the nation, spurs innovation, creates new customers, and promotes global growth and prosperity.

The best way for the American automotive industry, of which we are proud to be a part, to improve our competitiveness is to improve the quality and prices of our products, and our delivery and product development capabilities. The best way to retard our competitiveness is for the government to intrude into the market, as through quotas, VIEs, domestic content or purchasing requirements, or other mandates. Such intrusion is inconsistent with the commercial considerations that are the lifeblood of competition in a free market economy.

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